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60/200821

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Mailed April 28, 2000



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Tentative Applicant Name:  
Brian L. Whitworth

Title:  
A METHOD OF CREATING NEW SECURITIES FROM EQUITIES: SEPARATELY TRADABLE REGISTERED INDEPENDENT DIVIDEND AND EQUITY SECURITIES ("STRIDES")

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- (x) Provisional Claims, sheets: 6
- (x) Prior art, sheets: 134
- (x) Small Entity Declaration(s), number: 1
- (x) Check for \$ 75 for (x) small entity ( ) large entity filing fee

60/200821

Very respectfully,

  
Brian L. Whitworth  
3003 Sequit Dr.  
Malibu, CA 90265  
310.456.9693

EK527164103US

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Date of Deposit: April 28, 2000

**A METHOD OF CREATING NEW SECURITIES FROM EQUITIES:  
SEPARATELY TRADABLE REGISTERED INDEPENDENT DIVIDEND AND  
EQUITY SECURITIES ("STRIDES")**



5    **BACKGROUND OF THE INVENTION**

**Field of the Invention**

The present invention relates to methods of creating new securities from common stock. The new securities separate dividend payments from stock appreciation or depreciation and allow separate ownership and trading of each.

10

**Description of the Related Art**

**Common Stock**

A number of different methods of investing in common stock currently exist. Individual stocks may yield substantial dividends, small dividends or no dividends at all. Dividends potentially produce a number of problems for individual and institutional investors.

15

For most investors, cash dividends are currently taxed as ordinary income when the dividend is received. By contrast, any profit from the appreciation of stock is not taxed until the stock is sold. Profits from the sale are usually taxed at a lower rate than dividends.

20

Paying dividends to large numbers of stockholders is an involved task for many publicly held companies. Some companies have millions of shareholders who receive quarterly checks. Particularly for individual investors, many of these checks are small, often under \$20 per quarter, and can become a nuisance. Many companies allow shareholders to elect "dividend reinvestment", where dividends for that shareholder are not paid in cash, but are used to purchase small amounts of additional stock. In the case where a shareholder elects dividend reinvestment, taxation and tax accounting are similar to receiving dividends in cash. Many investors receive dividends in cash and make donations to not-for-profit organizations. Though contributions to not-for-profits can offset taxes on dividend income, a typical process is: 1) investor receives a dividend check, 2) deposits that check, 3) investor writes another check to a charity or other not-

25

30

for-profit, 4) receives receipt from not-for profit, 5) receives tax forms from company which paid dividends, 6) fills in tax forms with relevant information.

5 An oddity of tax policy in the U.S. is that the same investor may make very different investment decisions on tax exempt or tax deferred retirement accounts than taxable investment accounts due to the different tax treatment of dividends. For example, an investor might have a portfolio in their retirement account with a higher dividend yield than in their taxable account.

10 Mutual funds and pension funds receive large amounts of dividends quarterly and often will immediately reinvest the proceeds. In some cases, the mutual fund or pension fund would prefer not to have the administrative burden of reinvestment.

### **Index Funds**

15 A number of funds attempt to track the performance of a particular group of stocks, such as utility stocks, stocks in the S&P 500, or stocks in the Nasdaq 100 Index. Among these funds are unit investment trusts and mutual funds. An example of a tracking mutual fund is the Vanguard 500 Fund, which attempts to mirror the S&P 500 index. A similar unit investment trust which is traded on exchanges in the same manner as stock in an individual company, is the SPDR (traded on the American Exchange, symbol SPY). A prospectus for the SPDR investment is incorporated by reference.

20 Index funds consolidate dividends from stocks owned by the fund and pay the appropriate amount to each of the funds' investors. While there are far fewer dividend checks than if fund investors owned individual stocks directly, the investor will still need to decide on whether to reinvest the dividends and will still have to pay applicable taxes on the dividends when received.

25

### **Treasury Strips**

U.S. Treasury strips have been available since 1985. These strips separate a Treasury bond into multiple securities, one for each principal or interest payment. Thus, a 10-year Treasury can be stripped with 21 resulting securities (1 principal payment and



20 interest payments, one every 6 months for the 10 year term). Each of the resulting stripped securities can be traded separately, much like a zero-coupon bond.

While stock dividends have some similarities to interest payments on bonds and stock prices have a lesser similarity to bond principal, the mechanism for creating  
5 STRIDES described herein typically creates only one new security for all future dividend payments and a separate security which is a nondividend paying stock. Of course, STRIDES apply to a large and diverse group of equities with various risk profiles, whereas Treasury STRIPS apply to fixed income securities from a single issuer, the U.S. Government

10

Presently, there are no known exchange-traded securities which allow an investor to separate ownership of a dividend-paying stock into components which allow the dividends to be separately owned and traded. Similarly, there are no known exchange-traded securities which allow an investor to separate ownership of an index or mutual  
15 fund of multiple stocks into components which allow the dividends of stocks in such index or fund to be separately owned or traded.

In view of the foregoing, there is clearly a need for a method of creating securities which allow separate ownership of dividend streams from individual stocks or stock  
20 index funds.

Accordingly, it is an object of the present invention to provide methods for allowing investors to separately purchase, trade, or sell dividend streams of a single stock.

25 It is another object of the present invention to provide methods for allowing investors to separately purchase, trade, or sell dividend streams of multiple stocks in an index or mutual fund.

It is another object to provide substantial additional flexibility and investment options for individuals and institutions.

It is another object to facilitate and simplify charitable contributions and related tax treatment.

It is another object to allow the creation of new financial and investment products which are made possible by STRIDES.

5        It is another object provide an opportunity for market forces to value stock appreciation and dividends separately.

It is another object to provide a method for reducing administrative burdens for investors who prefer not to receive dividends.

10       It is another object to provide methods of trading options and futures on new securities created by STRIDES.

It is another object to allow creation of index shares which track an index of stocks minus ordinary dividends.

#### SUMMARY OF THE INVENTION

15       An exemplary preferred method according to the present invention includes one or more of the following steps: taking one or more stocks, stock indexes, or mutual funds; creating exchange-traded securities which allow the separation or stripping of ordinary dividends; creating original issue stock which can be separated into a tradable dividend security and a nondividend-paying security; and creating related futures and options.

20       According to an exemplary preferred method of the present invention, equity dividend strips, equity dividend strip futures, equity dividend strip options, new index fund stocks, new mutual fund investments, and related securities are created in consideration of the cash dividends paid by companies issuing the original stock. Similar financial products are created for nondividend paying stock.

25       Additionally, the principles of the present invention can be employed to provide new corporate financing methods which make use of the aforementioned securities. An example of such a new method is the issuance of original common stock with a detachable dividend strip.

30

## DESCRIPTION OF THE DRAWINGS

Other objects, features and advantages of the invention will become readily apparent upon reference to the following detailed description when considered in conjunction with the accompanying drawings, in which like reference numerals designate like parts throughout the figures thereof, and wherein:

FIG. 1 is a high level, functional flowchart embodying an exemplary preferred system and method according to the present invention.

FIG. 2 is a flowchart showing steps involved in creating an equity dividend strip and a nondividend-paying security for a single stock.

FIG. 3 is a flowchart showing steps involved in creating an equity dividend strip and a nondividend-paying security for or an index of multiple stocks.

FIG. 4 is a flowchart shows steps involved in creating a standalone equity dividend strip future or option for a single stock or an index of multiple stocks.

FIG. 5 is a flowchart showing how a company can issue its own common stock with a detachable dividend strip.

## DETAILED DESCRIPTION OF THE PREFERRED EMBODIMENTS

An exemplary preferred embodiment of the present invention is adapted to create equity dividend strips and nondividend paying stock.

### **Major Inputs and Outputs**

Referring to FIG. 1, an exemplary preferred system 100 according to the present invention uses stock in one or more companies 101 and an equity dividend stripping mechanism 103, to create nondividend yielding stock 105 and stock equity dividend strips 107. Once issued, nondividend yielding stock 105 and stock equity dividend strips 107 can be owned and traded separately, or can be recombined into a dividend-paying stock. Thus, trading in nondividend stock 109 and equity strips 113 may occur

separately, or the nondividend stock 109 and matching equity strips 113 may be reassembled into dividend-paying stock 111.

5 Most mechanisms available for owning or trading shares in a company, an index fund, or a mutual fund are theoretically available for trading nondividend stock 105 and stock equity dividend strips 107. Such ownership and transfer mechanisms include, but are not limited to: transfer on an organized exchange, transfer over the counter, and private transactions with no publicly available record of the transactions.

10 Multiple equity dividend stripping mechanisms 103, are described in FIGS. 2 through 5.

#### **Equity Strips for an Existing Stock In a Single Compan**

15 FIG. 2 illustrates steps of an exemplary preferred method 200 for creating equity dividend strips using existing shares of a single company.

At step 201, a stock is selected for equity stripping. There are a large number of possible methods for selecting such a stock. Such methods might include: a request from the company whose outstanding stock will be stripped; choosing a company with a large number of outstanding shares and a high dividend yield; performing surveys or market  
20 research among potential investors; financial ratio analysis; choosing a company which currently does not pay dividends, but may do so in the future; or searching for a company with a high number of dividend checks issued each quarter.

At step 203, the new securities are specified. In the preferred embodiment, ordinary cash dividends are separated from the remainder of risks and cash flows from an  
25 individual stock. There are a large number of other possible permutations. The dividend strip could include dividends paid in stock as well as those paid in cash, for example.

Nothing prevents a similar mechanism from being used to separate voting rights from the underlying shares. Such a mechanism might prove useful to institutional investors who wish to provide others power and discretion in shareholder voting.

At step 205, government filings for the new securities are created. In the U.S. such filings are usually made with the Securities Exchange Commission (SEC). The methods for creating SEC filings are familiar to those skilled in the art of creating initial public offerings or subsequent issuances of additional shares.

5        At step 207, original shares of stock are purchased for creation of derivative securities 209. The multiple classes of new securities are put on sale to the public 211. New securities include an aftermarket nondividend-paying stock in a single company 213 and an aftermarket equity strip in a single company 215.

10       It is possible that demand exceeds supply for the new securities 213 and 215. If more shares are needed now 217, a "yes" allows the process to repeat as needed from step 205 government filings. If no more shares are needed now, the process stops or waits for additional demand at a later date 219.

## 15    **Equity Strips for Multiple Existing Stocks**

FIG. 3 illustrates steps of an exemplary preferred method 300 for creating equity dividend strips using existing shares of a multiple companies.

20       At step 301, stocks are selected for equity stripping. There are a large number of possible methods for selecting such stocks. Such methods might include: a request from the an exchange or publisher whose stock index will be stripped (e.g., S&P 500, Dow  
25       Industrials); choosing a group of companies with a large number of outstanding shares and a high dividend yield; choosing an industry group, such as banking or utilities; performing surveys or market research among potential investors; financial ratio analysis; choosing companies which currently do not pay dividends, but may do so in the future;  
30       choosing companies which are owned by a particular mutual fund; choosing companies which are part of an index stock (such as the NASDAQ index stock QQQ or the S&P 500 index stock SPDR currently traded on the American Exchange) or searching for a group of companies with a high number of dividend checks issued each quarter.

30       At step 303, the new securities are specified. In the preferred embodiment, ordinary cash dividends are separated from the remainder of risks and cash flows from

the stocks. As with individual stocks, there are a number of other possible permutations. With multiple stocks, certain choices are available which are difficult or impossible with a single stock, such as directing income from an equity dividend strip to a particular investment.

5           At step 305, government filings for the new securities are created. In the U.S. such filings are usually made with the Securities Exchange Commission (SEC).

          At step 307, original shares of stocks, index stocks, unit investment trust, mutual funds, or other securities based on common stock are purchased for creation of derivative securities 309. The multiple classes of new securities are put on sale to the public 311.

10       New securities include aftermarket nondividend-paying stock 313 and aftermarket equity strips 315.

          It is possible that demand exceeds supply for the new securities 313 and 315. If more shares are needed now 317, a "yes" allows the process to repeat as needed from step 305 government filings. If no more shares are needed now, the process stops or waits for  
15       additional demand at a later date 319.

### **Creation of Equity Dividend Strip Traded Futures and Options**

          FIG. 4 illustrates steps of an exemplary preferred method 400 for creating equity dividend strip futures and/or options. Futures and options are created with the  
20       expectation that at least one party to a futures or option transaction does not own the underlying security.

          Though quite common, it is not a requirement that a particular futures or options contract is based on an exchange-traded security, or even any security at all. For example, there is no underlying security or commodity for the Quarterly Bankruptcy  
25       Index traded on the Chicago Mercantile Exchange. Similarly, it is possible to create futures and options contracts on a theoretical equity dividend strip even when the underlying equity dividend strip does not exist or is not traded.

          Step 401 involves choosing one or more stocks for equity strip futures. It is likely that high expected trading volume will be a consideration. Contract specifications for  
30       each future is then determined in step 403.

The same parties then determine which contracts should also have exchange traded options in step 405. When it appears that options are desirable, contract specifications for each option are set in step 407.

5 Necessary regulatory filing for futures and options are created in steps 409 and 411, respectively. Concurrent to, or subsequent to, regulatory filings, marketing and education for exchange members, brokers, and potential buyers and sellers are preferably provided in step 413.

### **Issuing Stock With Detachable Dividend Strips**

10 FIG. 5 illustrates an exemplary preferred method 500 for a company to issue its own common stock with a detachable dividend strip. The steps in FIG. 5 can be used virtually unchanged for shares in a single company's own stock, a mutual fund, a unit investment trust, or an index fund. In those cases, mutual fund, unit investment trust or index fund can be substituted for company and shares in the mutual fund, unit investment  
15 trust or index fund can be substituted for the single company stock.

There are three common circumstances treated in FIG. 5: the company has not yet issued publicly traded stock and will be performing an initial public offering (IPO), the company has outstanding publicly traded stock and will be issuing additional stock, and  
20 the company has outstanding publicly traded stock which it will be replacing with new securities.

At step 501, the issuing company reviews its circumstances to choose a method of sale or distribution for the new securities with detachable dividend strips. In some cases, the company will have only one choice, as would often happen with an IPO. In other  
25 cases, the company will have two or more viable options, as would often happen for a company which might issue additional stock or replace outstanding stock.

If the company chooses IPO, at step 503 the company creates specifications for IPO stock with detachable dividends. At step 505 necessary government filings are created, such as a prospectus. In most circumstances, there will be a single prospectus  
30 even though the securities can be separated. At step 507 the company and its investment

bankers or advisors sell the IPO stock with detachable dividends. Steps 503-507 are similar to creation of a traditional initial public offering. With the exception of creating stock with a detachable dividend strip, the process in steps 503-507 should be familiar to those skilled in the art of initial public offerings.

5        If the company chooses to issue additional stock at step 501, step 509 involves creating specifications for the additional stock. It would often be the case that such stock would be identical to already-issued shares, except that the additional stock would have detachable dividends. If both types of stock traded simultaneously, detachable dividend stock might trade at a premium over older shares, since its owner would have an  
10 investment option not available to owners of the older shares which did not have detachable dividends. If two different types of shares were trading simultaneously, the different types would likely require separate listings on one or more exchanges.

Step 511 involves the creation of government filings for the new securities in a manner similar to traditional offerings of additional stock in publicly held companies.  
15 Step 513 is the issuance of additional shares with detachable dividends. Steps 509-513 are similar to creation of an initial public offering. With the exception of creating stock with a detachable dividend strip, the process should be familiar to those skilled in the art of issuing additional stock in publicly held companies.

If the company chooses to replace existing shares at step 501, step 515 allows the  
20 company to specify the characteristics of the replacement stock. Note that a particular company might issue new shares with detachable dividends and simultaneously replace or exchange outstanding stock with new shares having detachable dividends. This would allow the company to have fewer types of securities trading at once.

Step 517 involves the creation of government filings for the new securities in a  
25 manner similar to replacement of stock as the result of a merger or company spinoff. Step 519 involves the exchange of outstanding stock for the new securities.

Regardless of the method by which new securities are sold or created, steps 507, 513, and 519 all lead to securities trading publicly at step 521. At least three different securities can be traded concurrently: single company equity strips 523, consisting of  
30 only the ordinary cash dividend payments; nondividend single company stock 525, which



does not pay cash dividends; and dividend paying single company stock 527, which behaves much like traditional company stock as long as the dividend strip(s) are not detached.

Equity strips 523, and nondividend company stock 525 can be recombined to  
5 create dividend paying stock 527. This process can also be reversed, so that dividend  
paying stock 527, can be separated into equity strips 523, and nondividend company  
stock 525. These processes of separation and recombination can occur repeatedly after  
issuance, usually at the discretion of investors. When separated, an investor has many  
options. Among these options, he may sell one security and retain the other, sell both  
10 securities at different times, hold one security in a retirement account and the other  
outside of a retirement account, or hold one security and donate another to a charity.

**I Claim:**

1           1.     A method of creating new securities from existing shares of common  
2 stock in one or more companies, the method comprising the step of:  
3           creating two new securities from the original common stock, said securities  
4 comprising an equity dividend strip and a nondividend paying stock.

1           2.     The method of claim 1 wherein:  
2 the common stock is a single class of stock in a single company.

1           3.     The method of claim 1 wherein:  
2 the common stock is stock from companies comprising a preexisting index.

1           4.     The method of claim 1 wherein:  
2 the common stock is stock from two or more companies.

1           5.     The method of claim 1 wherein:  
2 the common stock is owned indirectly via a mutual fund.

1           6.     The method of claim 1 wherein:  
2 the common stock is owned indirectly via a unit investment trust.

1           7.     The method of claim 1 wherein:  
2 the common stock is owned indirectly via index shares.

1           8.     The method of claim 1 wherein:  
2 the new securities are traded on an exchange.

1           9.     The method of claim 1 wherein:  
2 the new securities are traded over the counter.

1           10.    The method of claim 1 wherein:  
2           the new securities are privately traded.

1           11.    The method of claim 1 wherein:  
2           the same investor holds said equity dividend strips in a different account from  
3           said nondividend paying stock.

1           12.    The method of claim 12 wherein:  
2           an investor holds said equity dividend strips in a retirement account and holds  
3           said nondividend paying stock outside of a retirement account.

1           13.    The method of claim 12 wherein:  
2           an investor contributes said equity dividend strips to a charity and retains said  
3           nondividend paying stock.

1           14.    The method of claim 1 wherein:  
2           cash flows from said equity dividend strips are used to pay investment or brokerage  
3           expenses.

1           15.    Equity dividend strips comprising:  
2           a security which pays the security's owner an amount calculated in consideration  
3           of actual dividends paid by one or more companies, said amount not being calculated in  
4           consideration of market value of underlying stock of said one or more companies.

1           16.    The equity dividend strips of claim 15 wherein:  
2           the amount paid to the security's owner is calculated in consideration of actual dividends  
3           of one company.

1           17.    The equity dividend strips of claim 15 wherein:

2 the amount paid to the security's owner is calculated in consideration of actual dividends  
3 of two or more companies.

1 18. The equity dividend strips of claim 15 wherein:  
2 the amount paid to the security's owner is calculated in consideration of actual dividends  
3 of companies in a preexisting index.

1 19. The equity dividend strips of claim 15 wherein:  
2 the amount paid to the security's owner is calculated in consideration of actual dividends  
3 of companies in a specified group.

1 20. Shares with a detachable dividend strip comprising:  
2 a security which allows its owner to separate and transfer ownership of ordinary  
3 cash dividend payments.

1 21. The shares with a detachable dividend strip of claim 20 wherein:  
2 said shares with a detachable dividend strip are issued directly by the company in  
3 whom the shares provides ownership.

1 22. The shares with a detachable dividend strip of claim 20 wherein:  
2 said shares with a detachable dividend strip are not issued directly by the  
3 company in whom the shares provides ownership.

1 23. The shares with a detachable dividend strip of claim 20 wherein:  
2 said shares with a detachable dividend strip are issued by a mutual fund.

1 24. The shares with a detachable dividend strip of claim 20 wherein:  
2 said shares with a detachable dividend strip are issued by a unit investment trust.

1 25. Nondividend paying shares comprising:

2 a security which has the characteristics of common stock except that the security's  
3 specification does not provide for allowing payment of ordinary cash dividends to the  
4 security's owner.

1 26. The shares of claim 25 wherein:  
2 said security is issued directly by the company in whom the shares provides  
3 ownership.  
4

1 27. The shares of claim 25 wherein:  
2 said security is not issued directly by the company in whom the shares provides  
3 ownership.  
4

1 28. The shares of claim 25 wherein:  
2 said security is issued by a mutual fund.  
3

1 29. The shares of claim 25 wherein:  
2 said security is issued by a unit investment trust.  
3

1 30. Equity dividend strip futures or options comprising:  
2 an exchange traded futures or options contract including terms which are  
3 determined in consideration of actual dividend payments on shares of common stock in  
4 one or more companies.

1 31. The equity dividend strip futures or options of claim 30 wherein:  
2 said futures or options contract is based on terms determined in consideration of  
3 actual dividend payments of a single company's stock.

1           32.     The equity dividend strip futures or options of claim 30 wherein:  
2           said futures or options contract is based on terms determined in consideration of  
3     actual dividend payments of stock of more than one company.  
4

1           33.     The equity dividend strip futures or options of claim 30 wherein:  
2           said futures or options contract is based on terms determined in consideration of  
3     actual dividend payments of companies comprising a preexisting index.

1           34.     Separating a detachable equity dividend strip from a security issued with a  
2     detachable dividend strip.

1           35.     Combining one or more detachable equity strips and one or more  
2     nondividend paying stocks to recreate one or more shares of a security originally issued  
3     with a detachable dividend strip.

1           36.     Offering for sale to the public a security with a detachable equity dividend  
2     strip.

1           37.     Creating a futures or options contract on a detachable equity dividend  
2     strip.

1           38.     Donating a detachable dividend strip to a not-for-profit organization.

1           39.     Replacing outstanding ownership shares with shares having detachable  
2     equity dividend strips.

1           40.    Creating an initial public offering of shares having detachable equity  
2   dividend strips.

          41.    Creating an index fund or mutual fund which tracks the value of a  
preexisting income, said index fund having detachable dividend strips.

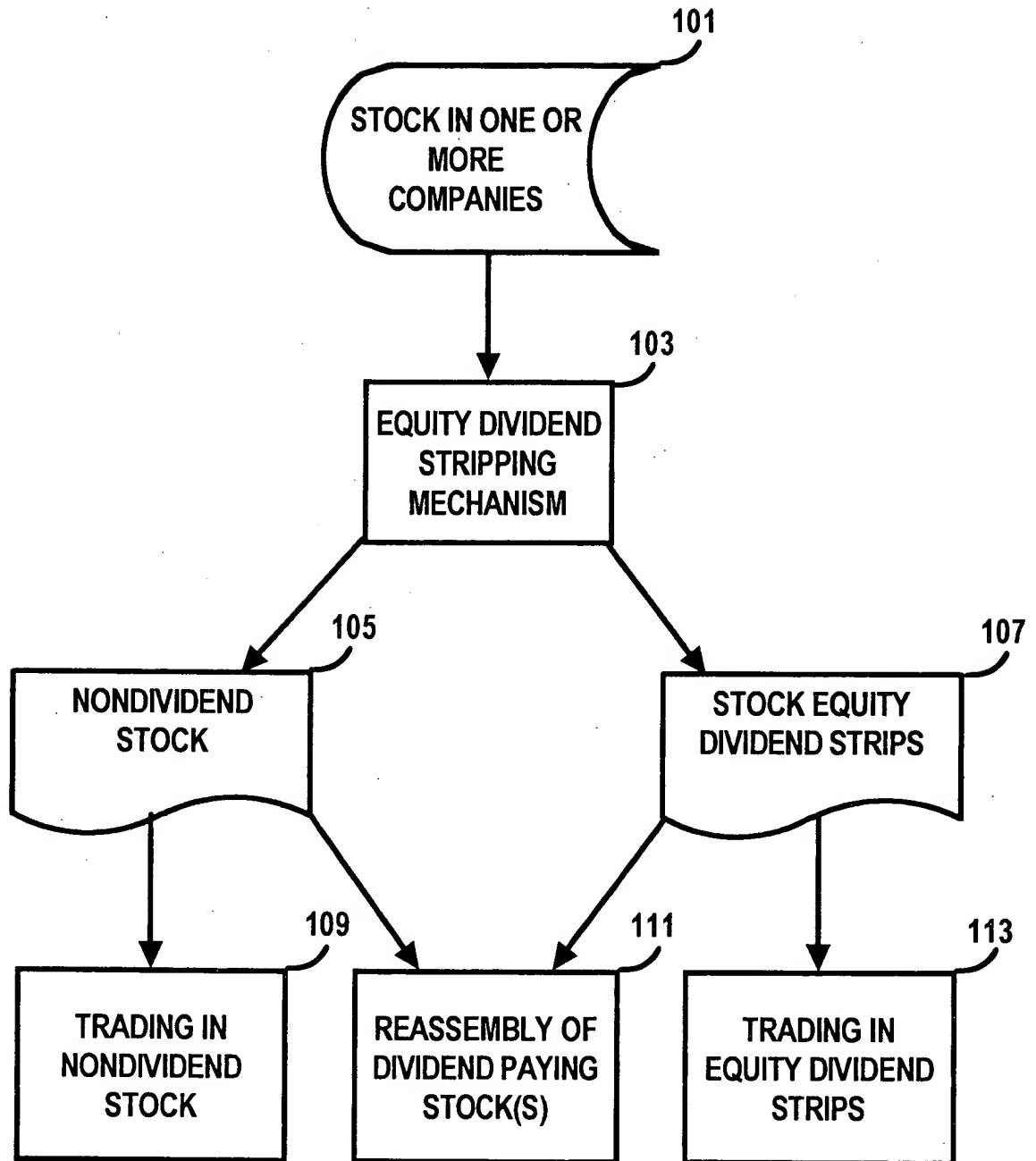
## **ABSTRACT OF THE DISCLOSURE**

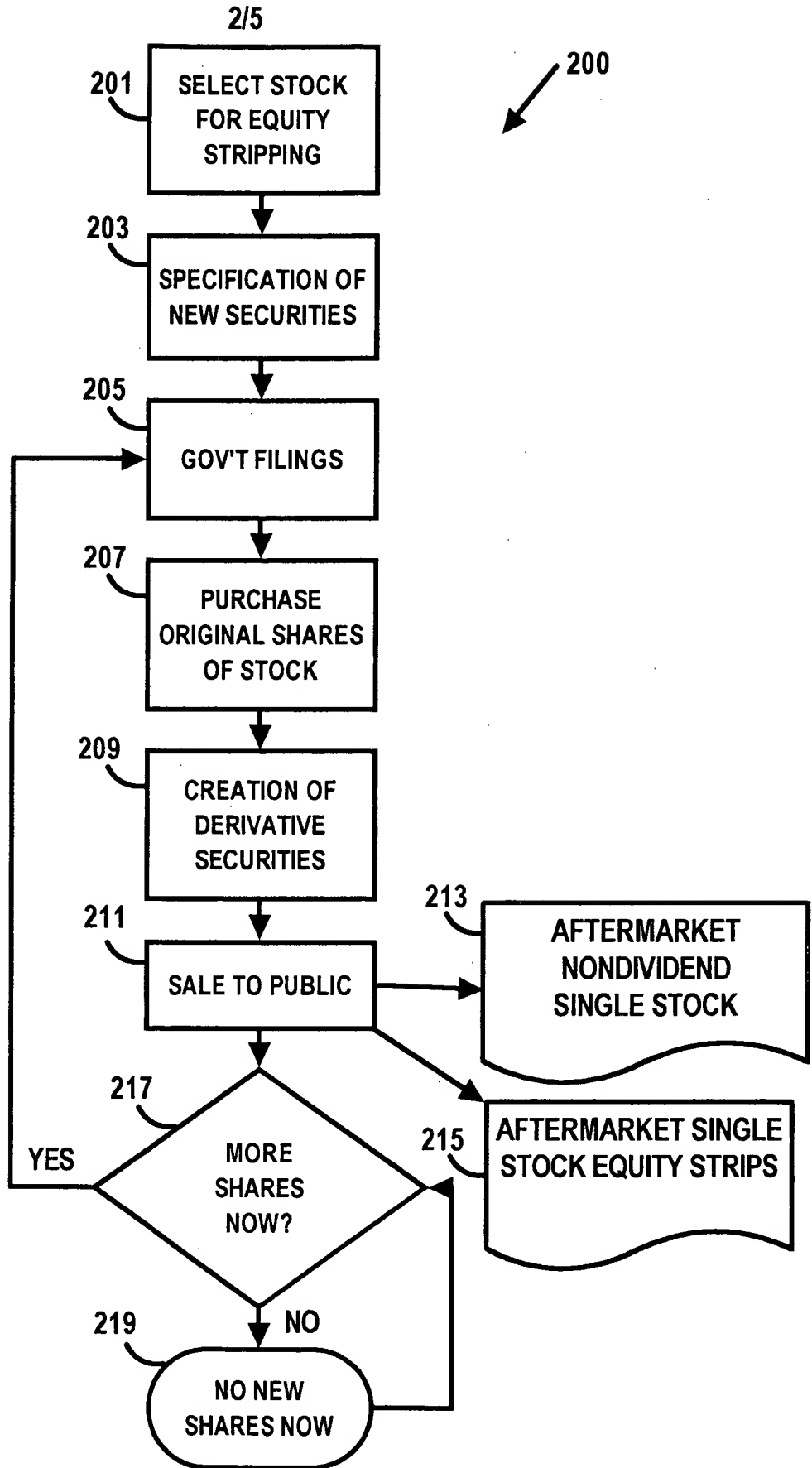
5       An method is disclosed for creating new types of securities, including equity dividend strips, equity dividend strip futures, equity dividend strip options, new index fund stocks, new mutual fund investments, and related securities are created in consideration of the cash dividends paid by companies issuing the original stock. Similar financial products are created for nondividend paying stock.

10       Additionally, the principles of the present invention can be employed to provide new corporate financing methods which make use of the aforementioned securities. An example of such a new method is the issuance of original common stock with a detachable dividend strip.

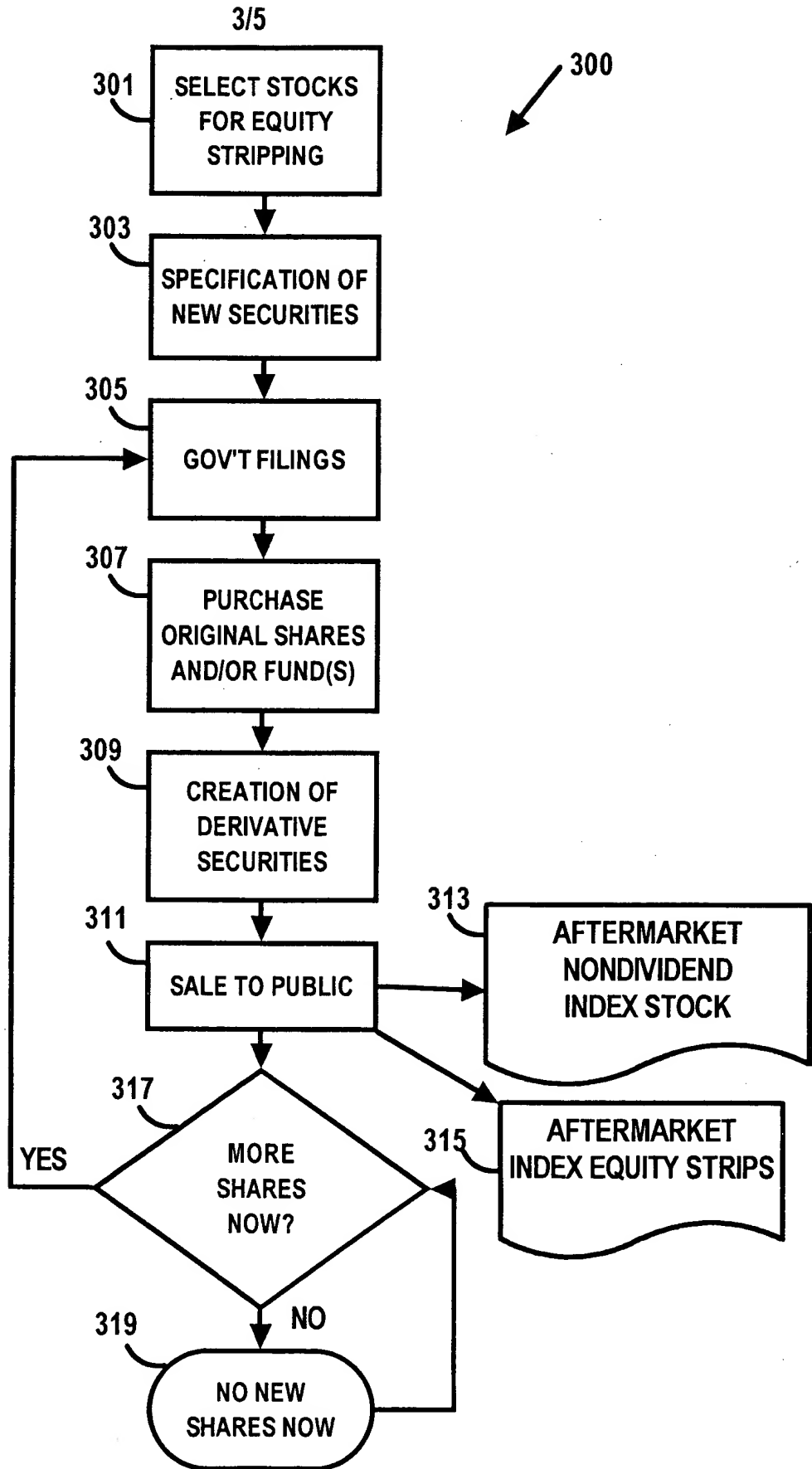
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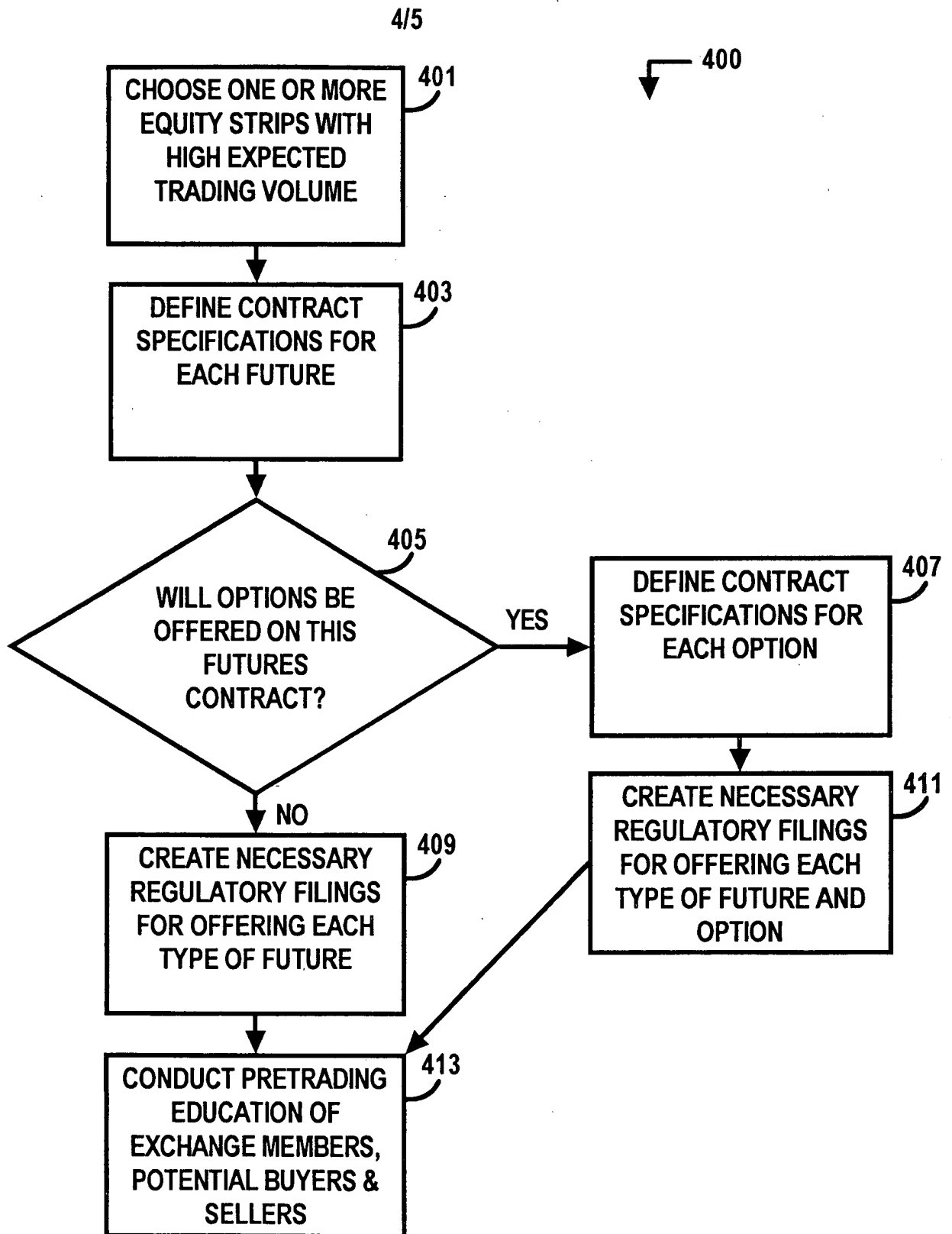
**FIG. 1**



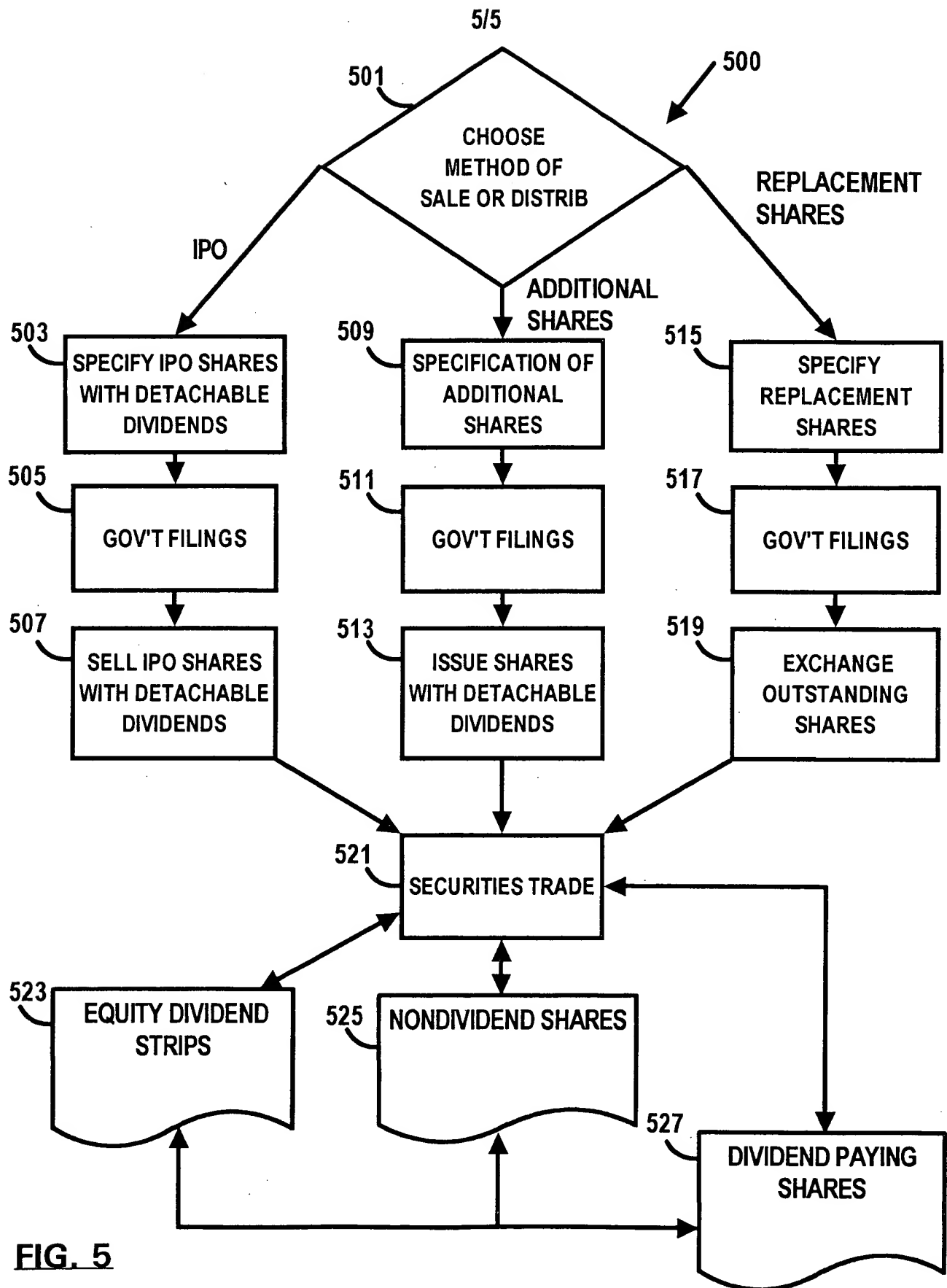
**FIG. 2**



**FIG. 3**



**FIG. 4**



Prospectus

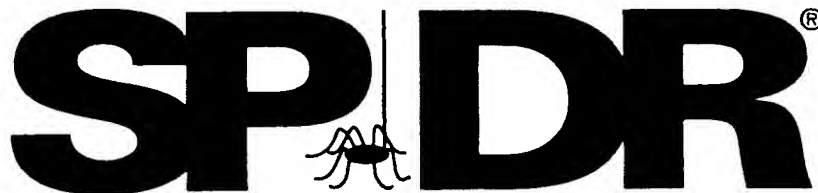
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**This Prospectus consists of two parts: Part A and Part B.**  
**Prospectus Part A Dated January 25, 1999**

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## **SPDRs PROSPECTUS PART A—HIGHLIGHTS**

- **SPDRs ARE OWNERSHIP INTERESTS IN THE SPDR TRUST**

The SPDR Trust (the “Trust”) is a unit investment trust that issues securities called Standard & Poor’s Depositary Receipts or “SPDRs”. SPDRs represent an undivided ownership interest in the portfolio of stocks held by the SPDR Trust. The SPDR Trust holds all of the common stocks of the Standard & Poor’s 500 Composite Stock Price Index® (the “S&P 500 Index”) and is intended to provide investment results that, before expenses, generally correspond to the price and yield performance of the S&P 500 Index.

- **SPDRs TRADE ON THE AMERICAN STOCK EXCHANGE**

SPDRs are listed for trading on the American Stock Exchange (the “Exchange”). SPDRs are bought and sold in the secondary market like ordinary shares of stock at any time during the trading day. SPDRs are traded on the Exchange in 100 SPDR round lots, but can be traded in odd lots of as little as 1 SPDR. Note that trading of SPDRs on the Exchange will be halted under the circumstances described in the paragraphs below relating to the risks of investing in SPDRs.

- **THE SPDR TRUST ISSUES AND REDEEMS SPDRs IN MULTIPLES OF 50,000 SPDRs CALLED “CREATION UNITS”**

The Trust only issues SPDRs in specified large-sized minimum numbers (50,000 SPDRs or multiples thereof) referred to as “Creation Units.” Most SPDR holders, however, purchase and sell SPDRs in the secondary trading market on the Exchange, in lots of any size.

Creation Units are issued by the Trust to anyone who, after placing a creation order with the Distributor, deposits with State Street Bank and Trust Company, the “Trustee” of the Trust, a specified portfolio of S&P 500 Index securities, as well as a cash payment generally equal to accumulated dividends of the securities (net of expenses) up to the time of deposit.

SPDRs are not individually redeemable, except upon termination of the Trust. SPDRs can be redeemed only by tendering to the Trust 50,000 SPDRs (or multiples thereof)—the same Creation Unit-sized minimum number. The Trust will then deliver a portfolio of S&P 500 Index securities (based on net asset value of the Trust), together with a cash payment (generally equal to accumulated dividends as of the date of redemption) to the redeeming holder.

Procedures to be followed when engaging in these “creation” and redemption transactions are set forth in Part B of this Prospectus.



- **BROKERAGE COMMISSIONS ON SPDRs**

Secondary market purchases and sales of SPDRs are subject to ordinary brokerage commissions.

- **SPDRs ARE BASED ON A BROAD MARKET INDEX**

The Sponsor selected the S&P 500 Index, composed of 500 publicly traded stocks, as the basis for SPDRs because it is well-known to investors and, in the opinion of the Sponsor, constitutes a representative segment of the market of all publicly traded stocks. Current information regarding the market value of the S&P 500 Index is available from market information services. Standard & Poor's obtains information for inclusion in or for use in the calculation of the S&P 500 Index from sources which S&P considers reliable, but neither S&P, the Sponsor, the Trust nor the Exchange accepts responsibility for or guarantees the accuracy and/or completeness of the S&P 500 Index or any data included in it.

- **SPDRs SHOULD CLOSELY TRACK THE VALUE OF THE UNDERLYING S&P 500 INDEX STOCKS**

To maintain the correspondence between the composition and weightings of securities held by the Trust (the "Securities") and the stocks in the S&P 500 Index, the Securities will be adjusted by the Trustee from time to time to conform to periodic changes in the identity and/or relative weightings of S&P 500 Index stocks. The SPDR Trust Agreement contains directions to the Trustee specifying how changes to the S&P 500 Index are to be replicated by the Trust.

The value of SPDRs will fluctuate in relation to changes in the value of the Trust's portfolio of securities. However, at any point in time, the market price of each individual SPDR may not be identical to the net asset value of such SPDR. Historically, these two valuations have been very close. See Part B of this Prospectus for a description of the comparisons of market price and net asset value. Of course, these comparisons only reflect past performance and no guarantee can be made of future performance.

The current value of the S&P 500 Index will ordinarily continue to be reported even when trading is interrupted in some or all of its component stocks. In that event, the reported index level will be based on the current market price of those stocks still being traded (if any) and the last reported prices for those stocks that are not currently trading. As a result, reported index levels may at times be based on non-current price information with respect to some or even all of the stocks in the S&P 500 Index.

- **EXPENSES OF THE TRUST**

Fees and expenses to be charged to the Trust are described in Part B of this Prospectus and include, among other costs, the Trustee's fees, S&P licensing fees,

federal registration fees and expenses of the Sponsor relating to the printing and distribution of marketing materials. The expenses of the Trust will be accrued daily and reflected in the net asset value of the Trust. The Trustee is currently accruing ordinary operating expenses at an annual rate of 0.18%:

*Estimated Trust Annual Ordinary Operating Expenses*

	<u>As a % of Trust Net Assets</u>
Trustee's Fee	0.1063%
S&P License Fee	0.0300%
Registration Fees	0.0092%
Marketing Expenses	0.0282%
Other Operating Expenses	0.0063%
<b>Total:</b>	<b>0.1800%</b>

Future accruals will depend primarily on the level of the Trust's net assets and the level of expenses. There is no guarantee that the Trust's ordinary operating expenses will not exceed 0.18% of the Trust's daily net asset value. Historically, the ordinary operating expenses of the Trust have not been permitted to exceed 0.1845% of the Trust's daily net asset value because the Sponsor has in the past reimbursed the Trust for all ordinary operating expenses in excess of such amount. The Sponsor reserves the right to discontinue this reimbursement policy in the future.

• **SPDRs MAKE PERIODIC DIVIDEND PAYMENTS**

SPDR holders will be paid on the last Business Day of April, July, October and January an amount corresponding to the amount of any cash dividends on the Trust's portfolio of securities during the applicable period, net of fees and expenses associated with operation of the Trust. Because of such fees and expenses, the dividend yield for SPDRs will ordinarily be less than that of the S&P 500 Index. The SPDR holder should be aware of the tax consequences associated with Trust dividends, as well as those associated with SPDR sales or redemptions. Investors should consult their tax advisors in this regard.

• **THE TRUSTEE VOTES THE UNDERLYING SHARES**

The Trustee will vote any voting stocks held by the Trust in the same proportion as all other voting shares of such stocks are voted. Consequently, holders of SPDRs will not be able to vote the shares of the stocks underlying the SPDRs.

• **TERMINATION OF THE SPDR TRUST**

The SPDR Trust has a specified lifetime term. The Trust is scheduled to terminate no later than January 22, 2118, but it may terminate earlier under certain circumstances described in Part B of this Prospectus.

Trading of SPDRs cannot occur after termination of the underlying Trust. Upon termination, the Trust may be liquidated, and SPDR holders at that time will receive a distribution of their pro rata share of the assets of the Trust, net of certain fees and expenses.

- **RISK FACTORS**

Investors can lose money by investing in SPDRs. Investors should carefully consider the risk factors described below together with all of the other information included in Part B of this Prospectus before deciding to invest in SPDRs.

- SPDRs are subject to the risks of any investment in a broadly based portfolio of common stocks, including the risk that the general level of stock prices may decline. A significant decline in the value of the Trust's portfolio can be expected to result in a similar decline in value of the corresponding SPDRs. Therefore, the value an investor receives from the sale of a SPDR may be less than the investor's original purchase price.
- Investors should understand that the Trust may never be able to replicate exactly the performance of the S&P 500 Index because of the operational fees and expenses incurred by the Trust or because of the temporary unavailability of certain S&P 500 Index securities.
- Investors cannot be assured that the issuers of securities held by the Trust will pay dividends, and distributions on such securities will generally depend upon the declaration of dividends by the securities' issuers.
- The market price that an investor pays per SPDR on the Exchange may differ from the net asset value of the SPDR. This difference in price may be due to the fact that the supply and demand in the market for SPDRs at any point in time is not always identical to the supply and demand in the market for the underlying basket of S&P 500 Index securities.
- Investors will not be able to sell SPDRs during any period that the Exchange halts trading in SPDRs. The Exchange may halt the trading of SPDRs under certain circumstances described in Part B of this Prospectus, for example, as a result of the activation of market-wide "circuit breakers," or whenever Exchange officials determine that it is appropriate in the interest of a fair and orderly market or to protect investors.
- The Exchange maintains certain requirements to list securities, including SPDRs, on the Exchange. Investors cannot be assured that the Trust will continue to meet the requirements necessary to maintain the listing of SPDRs on the Exchange or that the Exchange will not change the listing requirements. The Trust may be terminated if SPDRs are delisted from the Exchange.
- The Sponsor of the Trust has been granted a license to use the S&P 500 Index as a basis for determining the composition of the Trust and to use certain trade

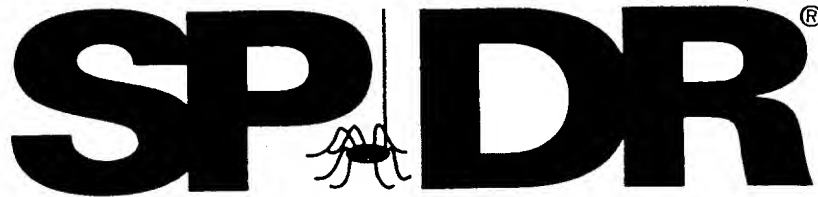
names and trademarks of Standard & Poor's. The Trust may be terminated if the license agreement is terminated.

- The Trust may also be terminated if the net asset value of the entire Trust falls below \$350,000,000.
- SPDRs are subject to the risk that extraordinary events may cause any of the providers of services to the Trust, such as the Trustee or the Sponsor, to close or otherwise fail to perform its obligations to the Trust. In the event of such a failure, if no suitable successor is available or willing to assume the obligations of its predecessor, the Trust then will be terminated.
- Many computer systems were designed in such a way that they may be unable to distinguish between the year 2000 and the year 1900 and therefore may not properly process and calculate date-related information and data (commonly known as the "Year 2000 Problem"). As with all investment and financial companies, the Year 2000 Problem may have an adverse impact upon the Trust. The Sponsor and the Trustee are taking steps to address the Year 2000 Problem with respect to the computer systems they use and to obtain reasonable assurances that similar steps are being taken by the Trust's other service providers. At this time, however, there can be no assurance that these steps will be sufficient to avoid any adverse impact to the Trust. The Year 2000 Problem is expected to have an impact on all corporations, including those whose stocks are contained in the Trust's Portfolio. The Sponsor cannot predict what impact, if any, the Year 2000 Problem will have on the stocks in the Trust.

**STANDARD & POOR'S DEPOSITARY RECEIPTS®**  
**(“SPDRs”®)**

**SPDR Trust, Series 1**

**(A Unit Investment Trust)**



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**THE SECURITIES AND EXCHANGE COMMISSION HAS NOT APPROVED  
OR DISAPPROVED THESE SECURITIES NOR PASSED UPON THE  
ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE  
CONTRARY IS A CRIMINAL OFFENSE.**

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**This Prospectus consists of two parts: Part A and Part B.  
Prospectus Part B Dated January 25, 1999**

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**SPDR PROSPECTUS PART B—ESSENTIAL INFORMATION AS OF  
SEPTEMBER 30, 1998†**

Number of SPDRs	79,266,004
Fractional Undivided Interest in Trust Represented by each SPDR	1/79,266,004 <sup>th</sup>
Record Date:	Quarterly, on the second Business Day after the third Friday in each of March, June, September and December.††
Dividend Payment Dates:	Quarterly, on the last Business Day of April, July, October and January.††
Trustee's Annual Fee:	From 11/100 of one percent to 15/100 of one percent, based on net asset value of the Trust, as the same may be reduced by certain amounts, plus (or minus) the Adjustment Amount.†††
Estimated Ordinary Operating Expenses of the Trust:	18/100 of one percent (0.18%) (inclusive of Trustee's annual fee).†††
Net Asset Value per SPDR (based on the value of the Securities, other net assets of the Trust and number of SPDRs outstanding)	\$101.80
Evaluation Time:	Closing time of the regular trading session on the New York Stock Exchange, Inc. (ordinarily 4:00 p.m. New York time).
Licensors:	Standard & Poor's, a division of The McGraw-Hill Companies, Inc.
Mandatory Termination Date:	The first to occur of (i) January 22, 2118 or (ii) the date 20 years after the death of the last survivor of eleven persons named in the Agreement, the oldest of whom was born in 1990 and the youngest of whom was born in 1993.

Discretionary Termination:

Trust may be terminated if at any time the value of the securities held by the Trust is less than \$350,000,000, as such amount shall be adjusted for inflation.††††

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† The Trust Agreement became effective and the initial deposit was made on January 22, 1993 (the “Initial Date of Deposit”).

†† See “Administration of the Trust—Distributions to Beneficial Owners”.

††† Until further notice, the Sponsor has undertaken that the ordinary operating expenses of the Trust as calculated by the Trustee will not be permitted to exceed an amount which is 0.1845% of the daily net asset value of the Trust. Thereafter, such amount may be changed and may exceed 0.1845%. See “Expenses of the Trust”. Ordinary operating expenses are currently being accrued at an annual rate of 0.18%; future accruals will depend primarily on the level of the Trust’s net assets and the level of Trust expenses. There is no guarantee that the Trust’s ordinary operating expenses will not exceed 0.18% of the Trust’s daily net asset value and such rate may be changed without notice.

†††† The Trust may also be terminated under other circumstances. See “Administration of the Trust—Termination”.

**SPDR Trust Series 1**  
**Report of Independent Accountants**

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To the Trustee and Unitholders of  
SPDR Trust Series 1

In our opinion, the accompanying statement of assets and liabilities, including the schedule of investments, and the related statements of operations and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of SPDR Trust Series 1 (the "Trust") at September 30, 1998, and the results of its operations, the changes in its net assets and the financial highlights for the periods indicated, in conformity with generally accepted accounting principles. These financial statements and financial highlights (hereafter referred to as "financial statements") are the responsibility of the Trust's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with generally accepted auditing standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of investments owned at September 30, 1998 by correspondence with the custodian and brokers, provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

Boston, Massachusetts  
November 23, 1998



**SPDR Trust Series 1**  
**Statement of Assets and Liabilities**  
**September 30, 1998**

<b>Assets</b>	
Investments in securities, at value (cost \$8,705,757,098) . . . .	\$8,052,798,893
Cash . . . . .	29,508,087
Receivable for investments sold . . . . .	40,492,999
Dividends receivable . . . . .	10,157,070
<b>Total Assets</b> . . . . .	<b>8,132,957,049</b>
<b>Liabilities</b>	
Payable for investments purchased . . . . .	27,938,301
Payable for income delivered for SPDR's redeemed in-kind . .	140,581
Distributions payable . . . . .	27,343,651
Due to Sponsor . . . . .	3,706,835
Accrued Trustee fees . . . . .	2,206,713
Accrued expenses and other liabilities . . . . .	2,276,843
<b>Total Liabilities</b> . . . . .	<b>63,612,924</b>
<b>Net Assets</b> . . . . .	<b>\$8,069,344,125</b>
<b>Net assets represented by:</b>	
Paid in surplus relating to 79,266,004 units of fractional undivided interest ("SPDRs") outstanding; unlimited units authorized . . . . .	\$8,747,556,906
Distribution in excess of net investment income . . . . .	(3,802,740)
Accumulated net realized loss on investments . . . . .	(21,451,836)
Net unrealized depreciation on investments . . . . .	(652,958,205)
<b>Net Assets</b> . . . . .	<b>\$8,069,344,125</b>
<b>Net asset value per SPDR (\$8,069,344,125/79,266,004 SPDRs) . .</b>	<b>\$ 101.80</b>

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Statement of Operations**

	For the year ended September 30, 1998	For the nine month period ended September 30, 1997	For the year ended December 31, 1996	For the year ended December 31, 1995
<b>Investment Income</b>				
Dividend income(a) .....	\$ 93,269,315	\$ 38,356,337	\$ 29,620,992	\$ 16,060,887
<b>Expenses</b>				
Trustee expense .....	6,990,046	2,578,842	1,806,689	909,805
S&P license fee .....	2,504,990	563,541	347,506	218,098
Marketing expense .....	2,213,340	431,452	436,049	—
SEC registration expense .....	1,125,070	450,401	203,447	136,000
Legal and audit services .....	229,520	143,826	135,000	80,000
Other expenses .....	130,705	90,978	41,002	21,000
Amortization of organization costs .....	35,416	81,912	110,000	110,000
Total expenses .....	13,229,087	4,340,952	3,079,693	1,474,903
Rebate from Sponsor .....	(410,301)	(249,830)	(434,407)	(180,244)
Rebate from Trustee .....	(1,149,645)	—	—	—
Net expenses .....	11,669,141	4,091,122	2,645,286	1,294,659
Trustee earnings credit .....	(488,977)	(194,498)	(176,370)	(107,356)
Net expenses after Trustee earnings credit .....	11,180,164	3,896,624	2,468,916	1,187,303
<b>Net investment income</b> .....	<b>82,089,151</b>	<b>34,459,713</b>	<b>27,152,076</b>	<b>14,873,584</b>
<b>Realized and unrealized gain on investments</b>				
Net realized gain on investment transactions .....	1,878,084,944	4,973,050	12,398,283	6,289,657
Net increase in unrealized appreciation (depreciation) ..	(1,707,909,730)	644,808,026	236,120,771	170,848,065
<b>Net realized and unrealized gain on investments</b> .....	<b>170,175,214</b>	<b>649,781,076</b>	<b>248,519,054</b>	<b>177,137,722</b>
<b>Net increase in net assets from operations</b> .....	<b>\$ 252,264,365</b>	<b>\$684,240,789</b>	<b>\$275,671,130</b>	<b>\$192,011,306</b>

(a) Net of withholding tax expense of \$586,136, \$289,809, \$182,561, and \$109,162 for 1998, 1997, 1996, and 1995, respectively.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Statement of Changes in Net Assets**

	For the year ended September 30, 1998	For the nine month period ended September 30, 1997	For the year ended December 31, 1996	For the year ended December 31, 1995
<b>Increase in net assets from operations:</b>				
Net investment income . . . . .	\$ 82,089,151	\$ 34,459,713	\$ 27,152,076	\$ 14,873,584
Net realized gain on investment transactions . . . . .	1,878,084,944	4,973,050	12,398,283	6,289,657
Net increase (decrease) in unrealized appreciation . . . . .	(1,707,909,730)	644,808,026	236,120,771	170,848,065
<b>Net increase in net assets from operations . . . . .</b>	<b>252,264,365</b>	<b>684,240,789</b>	<b>275,671,130</b>	<b>192,011,306</b>
<b>Undistributed net investment income included in price of units issued and redeemed, net . . . . .</b>	<b>6,830,907</b>	<b>420,891</b>	<b>1,962,474</b>	<b>325,692</b>
<b>Distributions to unitholders from:</b>				
Net investment income . . . . .	(82,089,151)	(33,466,398)	(27,037,456)	(14,873,584)
In excess of net investment income . . . . .	(4,796,055)	—	—	(310,588)
Net realized gains . . . . .	—	—	(3,078,255)	(128,321)
<b>Total distributions to unitholders . . . . .</b>	<b>(86,885,206)</b>	<b>(33,466,398)</b>	<b>(30,115,711)</b>	<b>(15,312,493)</b>
<b>Net increase in net assets from issuance and redemption of SPDRs . . . . .</b>	<b>3,844,189,382</b>	<b>1,393,422,226</b>	<b>759,578,491</b>	<b>401,629,719</b>
<b>Net increase in net assets during period . . . . .</b>	<b>4,016,399,448</b>	<b>2,044,617,508</b>	<b>1,007,096,384</b>	<b>578,654,224</b>
<b>Net assets at beginning of period . . . . .</b>	<b>4,052,944,677</b>	<b>2,008,327,169</b>	<b>1,001,230,785</b>	<b>422,576,561</b>
<b>Net assets end of period* . . . . .</b>	<b>\$ 8,069,344,125</b>	<b>\$4,052,944,677</b>	<b>\$2,008,327,169</b>	<b>\$1,001,230,785</b>
<b>*Includes undistributed (distributions in excess of) net investment income . . . . .</b>	<b>\$ (3,802,740)</b>	<b>\$ 993,315</b>	<b>\$ —</b>	<b>\$ (1,122,255)</b>

# SPDR Trust Series 1

## Financial Highlights

### Selected data for a SPDR outstanding during the period

	For the year ended 9/30/98	For the period ended 9/30/97	For the year ended 12/31/96	For the year ended 12/31/95	For the year ended 12/31/94	For the period ended 12/31/93(1)
<b>Net asset value, beginning of period</b> .....	\$ 94.78	\$ 74.08	\$ 61.61	\$ 45.93	\$ 46.62	\$ 43.54
<b>Investment Operations:</b>						
Net investment income .....	1.41	1.03	1.35	1.26	1.22	1.15
Net realized and unrealized gain (loss) on investments .....	7.01	20.67	12.52	15.70	(0.68)	3.06
<b>Total from investment operations</b> .....	8.42	21.70	13.87	16.96	0.54	4.21
<b>Less distributions from:</b>						
Net investment income .....	(1.32)	(1.00)	(1.28)	(1.24)	(1.23)	(1.10)
In excess of net investment income .....	(0.08)	—	—	(0.03)	—	—
Net realized gains .....	—	—	(0.12)	(0.01)	—	(0.03)
<b>Total distributions</b> .....	(1.40)	(1.00)	(1.40)	(1.28)	(1.23)	(1.13)
<b>Net asset value, end of period</b> .....	\$ 101.80	\$ 94.78	\$ 74.08	\$ 61.61	\$ 45.93	\$ 46.62
<b>Total investment return</b> .....	8.82%	29.38%	22.67%	37.23%	1.15%	9.78%
<b>Ratios and supplemental data ratio to average net assets:</b>						
Total expenses (2) .....	0.19%	0.19%(3)	0.20%	0.20%	0.20%	0.20%(3)
Net expenses after rebates and Trustee earnings credit (2) .....	0.18%	0.18%(3)	0.18%	0.19%	—	—
Net investment income .....	1.35%	1.63%(3)	2.03%	2.35%	2.63%	2.62%(3)
Portfolio turnover rate (4) ...	4.71%	3.22%	4.37%	4.02%	4.07%	2.40%
<b>Net assets, end of period (000's)</b> .....	\$8,069,344	\$4,052,945	\$2,008,327	\$1,001,231	\$422,577	\$461,557

(1) The Trust commenced operations on January 22, 1993.

(2) Net of expenses reimbursed by the Sponsor and Trustee in 1998 and Sponsor in 1994 through 9/30/97. If the Trust had borne all expenses reimbursed by the Sponsor and Trustee as noted, the ratio of expenses to average net assets would have increased by 0.03%, 0.02%, 0.03%, 0.03%, and 0.01% in 1998, 1997, 1996, 1995, and 1994, respectively.

(3) Annualized.

(4) Portfolio turnover ratio excludes securities received or delivered from processing creations or redemptions of SPDRs.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Notes to Financial Statements**  
**September 30, 1998**

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**Note 1—Organization**

SPDR Trust Series 1 (the "Trust") is a unit investment trust created under the laws of the State of New York and registered under the Investment Company Act of 1940. The Trust was created to provide investors with the opportunity to purchase a security representing a proportionate undivided interest in a portfolio of securities consisting of substantially all of the common stocks, in substantially the same weighting, which comprise the Standard & Poor's 500 Composite Price Index (the "S&P Index"). Each unit of fractional undivided interest in the Trust is referred to as a Standard & Poor's Depositary Receipt ("SPDR"). The Trust commenced operations on January 22, 1993 upon the initial issuance of 150,000 SPDRs (equivalent to three "Creation Units"—see Note 4) in exchange for a portfolio of securities assembled to reflect the intended portfolio composition of the Trust. Effective September 30, 1997, the fiscal year end of the Trust changed from December 31 to September 30.

**Note 2—Significant Accounting Policies**

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that effect the reported amounts and disclosures in the financial statements. Actual results could differ from these estimates. The following is a summary of significant accounting policies followed by the Trust.

**Security Valuation**

Portfolio securities are valued based on the closing sale price on the exchange which is deemed to be the principal market for the security. If no closing sale price is available, then the security is valued at the closing bid price on the exchange which is deemed to be the principal market for the security. If there is no closing bid price available, valuation will be determined by the Trustee in good faith based on available information.

**Investment Transactions**

Investment transactions are recorded on the trade date. Realized gains and losses from the sale or disposition of securities are recorded on the identified cost basis. Dividend income is recorded on the ex-dividend date.

**SPDR Trust Series 1**  
**Notes to Financial Statements (continued)**  
**September 30, 1998**

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**Distributions to Unitholders**

The Trust declares and distributes dividends from net investment income to its unitholders quarterly. The Trust will distribute net realized capital gains, if any, at least annually.

**Organization Costs**

The Trust incurred organization costs of \$549,500, which were capitalized and charged to operations ratably over a period of 60 months from the commencement of operations.

**Federal Income Tax**

The Trust has qualified and intends to qualify for and elect treatment as a "regulated investment company" under Subchapter M of the Internal Revenue Code of 1986, as amended. By so qualifying and electing, the Trust will not be subject to federal income taxes to the extent it distributes its taxable income, including any net realized capital gains, for each fiscal year. In addition, by distributing during each calendar year substantially all of its net investment income and capital gains, if any, the Trust will not be subject to federal excise tax. Income and capital gain distributions are determined in accordance with income tax regulations which may differ from generally accepted accounting principles. These differences are primarily due to differing treatments for income equalization, in-kind transactions and losses deferred due to wash sales. Net investment income per share calculations in the financial highlights for all years presented exclude these differences. During 1998, the Trust reclassified \$1,896,359,332 of non-taxable security gains realized in the in-kind redemption of Creation Units (Note 4) as an increase to paid in surplus in the Statement of Assets and Liabilities. At September 30, 1998, the Trust had a capital loss carryforward of \$33,523. This loss may be utilized to offset any net realized capital gains through September 30, 2005.

**Note 3—Transactions with the Trustee and Sponsor**

In accordance with the Trust Agreement, State Street Bank and Trust Company (the "Trustee") maintains the Trust's accounting records, acts as custodian and transfer agent to the Trust, and provides administrative services, including filing of all required regulatory reports. The Trustee is also responsible for determining the composition of the portfolio of securities which must be delivered in exchange for the issuance of Creation Units of the Trust, and for adjusting the composition of the Trust's portfolio from time to time to conform to changes in the composition and/or

**SPDR Trust Series 1**  
**Notes to Financial Statements (continued)**  
**September 30, 1998**

weighting structure of the S&P Index. For these services, the Trustee receives a fee at the following annual rates:

<u>Net asset value of the Trust</u>	<u>Fee as a percentage of net asset value of the Trust</u>
\$0—\$499,999,999	15/100 of 1% per annum plus or minus the Adjustment Amount
\$500,000,000—\$999,999,999	13/100 of 1% per annum plus or minus the Adjustment Amount
\$1,000,000,000—and above	11/100 of 1% per annum plus or minus the Adjustment Amount

The Adjustment Amount is the sum of (a) the excess or deficiency of transaction fees received by the Trustee, less the expenses incurred in processing orders for creation and redemption of SPDRs and (b) the amounts earned by the Trustee with respect to the cash held by the Trustee for the benefit of the Trust. During the year ended September 30, 1998, the Adjustment Amount reduced the Trustee's fee by \$464,611. The Adjustment Amount included a deficiency of net transaction fees from processing orders of (\$24,366) and a Trustee earnings credit of \$488,977.

For the year ended September 30, 1998, PDR Services LLC (the "Sponsor", a wholly-owned subsidiary of the American Stock Exchange LLC) and State Street Bank and Trust Company (the "Trustee") agreed to reimburse the Trust for, or assume, the ordinary operating expenses of the Trust which exceeded 18.45/100 of 1% per annum of the daily net asset value of the Trust. The amount of such reimbursement by the Sponsor and Trustee for the year ended September 30, 1998 was \$410,301 and \$1,149,645, respectively.

**Note 4—Trust Transactions in SPDRs**

Transactions in SPDRs were as follows:

	<u>Year Ended September 30, 1998</u>		<u>Nine Month Period Ended September 30, 1997 (Note 1)</u>	
	<u>SPDRs</u>	<u>Amount</u>	<u>SPDRs</u>	<u>Amount</u>
SPDRs sold .....	123,400,000	\$12,952,751,200	23,800,000	\$2,120,759,371
Dividend reinvestment SPDRs issued .....	3,020	309,869	4,003	328,997
SPDRs redeemed .....	(86,900,000)	(9,102,040,780)	(8,150,000)	(727,245,251)
Net income equalization .....	—	(6,830,907)	—	(420,891)
Net increase .....	<u>36,503,020</u>	<u>\$ 3,844,189,382</u>	<u>15,654,003</u>	<u>\$1,393,422,226</u>

**SPDR Trust Series 1**  
**Notes to Financial Statements (continued)**  
**September 30, 1998**

	Year Ended December 31, 1996		Year Ended December 31, 1995	
	SPDRs	Amount	SPDRs	Amount
SPDRs sold .....	15,750,000	\$1,100,700,575	11,700,000	\$ 640,975,632
Dividend reinvestment SPDRs issued .....	7,625	506,869	1,291	69,292
SPDRs redeemed .....	(4,900,000)	(339,666,479)	(4,650,000)	(239,089,513)
Net income equalization .....	—	(1,962,474)	—	(325,692)
Net increase .....	10,857,625	\$ 759,578,491	7,051,291	\$ 401,629,719

Except for under the Trust's dividend reinvestment plan, SPDRs are issued and redeemed by the Trust only in Creation Unit size aggregations of 50,000 SPDRs. Such transactions are only permitted on an in-kind basis, with a separate cash payment which is equivalent to the undistributed net investment income per SPDR (income equalization) and a balancing cash component to equate the transaction to the net asset value per unit of the Trust on the transaction date. A transaction fee of \$3,000 is charged in connection with each creation or redemption of Creation Units through the SPDR Clearing Process per Participating party per day, regardless of the number of Creation Units created or redeemed. Transaction fees are received by the Trustee and used to offset the expense of processing orders.

**Note 5—Investment Transactions**

For the year ended September 30, 1998, the Trust had in-kind contributions, in-kind redemptions, purchases and sales of investment securities of \$10,913,082,425, \$7,072,750,005, \$283,177,518, and \$288,937,344, respectively. At September 30, 1998, the cost of investments for federal income tax purposes was \$8,705,674,300, accordingly, gross unrealized appreciation was \$272,638,288 and gross unrealized depreciation was \$925,513,695, resulting in net unrealized depreciation of \$652,875,407.



**SPDR Trust Series 1**  
**Schedule of Investments**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
3Com Corp.*	346,282	\$ 10,410,103
Abbott Lab.	1,529,590	66,441,566
Adobe Systems, Inc.	70,555	2,447,377
Advanced Micro Devices, Inc.*	142,143	2,638,529
Aeroquip-Vickers, Inc.	29,251	840,966
Aetna, Inc.	145,118	10,085,701
Ahmanson (H.F.) & Co.	120,874	6,708,507
Air Products & Chemicals, Inc.	227,516	6,768,601
Airtouch Communications, Inc.*	562,294	32,050,758
Alberto-Culver Co., Class B	57,744	1,349,766
Albertson's, Inc.	238,026	12,883,157
Alcan Aluminum Ltd.	232,080	5,439,375
Allegheny Teledyne, Inc.	184,690	3,289,791
Allergan Pharmaceuticals, Inc.	66,318	3,871,313
Allied Signal, Inc.	559,998	19,809,929
Allstate Corp.	814,420	33,951,134
Alltel Corp.	265,992	12,601,371
Aluminum Co. of America	182,834	12,981,214
Alza Corp.	86,852	3,767,206
Amerada Hess Corp.	84,431	4,870,613
Ameren Corp.	132,636	5,562,422
American Electric Power Co., Inc.	192,636	9,403,045
American Express Co.	448,798	34,837,945
American General Corp.	250,929	16,028,090
American Greetings Corp., Class A	66,905	2,646,929
American Home Products Corp.	1,303,620	68,277,097
American International Group, Inc.	1,041,166	80,169,782
American Stores Co.	273,898	8,816,092
Ameritech Corp.	1,095,893	51,917,931
Amgen, Inc.*	248,162	18,751,741
Amoco Corp.	950,530	51,209,804
AMP, Inc.	221,171	7,906,863
AMR Corp.*	184,112	10,206,709
Anadarko Petroleum Corp.	118,570	4,661,283
Andrew Corp.*	91,919	1,217,927

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Anheuser-Busch Cos., Inc. ....	475,345	\$ 25,668,630
Aon Corp. ....	167,478	10,802,331
Apache Corp. ....	91,946	2,465,302
Apple Computer, Inc.* ....	130,275	4,966,734
Applied Materials, Inc.* ....	370,517	9,355,554
Archer-Daniels-Midland Co. ....	602,054	10,084,404
Armco, Inc.* ....	110,791	553,955
Armstrong World Industries, Inc. ....	41,612	2,226,242
ASARCO, Inc. ....	42,605	814,821
Ascend Communications, Inc.* ....	184,302	8,385,741
Ashland, Inc. ....	76,306	3,529,153
Associates First Capital Corp. ....	341,920	22,310,280
AT & T Corp. ....	1,794,103	104,842,894
Atlantic Richfield Co. ....	314,114	22,282,462
Autodesk, Inc. ....	47,724	1,252,755
Automatic Data Processing, Inc. ....	298,133	22,285,442
Autozone, Inc.* ....	151,731	3,736,376
Avery Dennison Corp. ....	109,216	4,771,374
Avon Products, Inc. ....	265,592	7,453,176
Baker Hughes, Inc. ....	320,220	6,704,606
Ball Corp. ....	31,015	1,093,279
Baltimore Gas & Electric Co. ....	150,706	5,029,813
Banc One Corp. ....	688,883	29,363,638
Bank of New York, Inc. ....	741,088	20,287,284
BankAmerica Corp. ....	677,995	40,764,449
BankBoston Corp. ....	295,604	9,754,932
Bankers Trust Co. (N.Y.) ....	89,825	5,299,675
Bard (C.R.), Inc. ....	58,392	2,153,205
Barrick Gold Corp. ....	374,090	7,481,800
Battle Mountain Gold Co. ....	231,897	1,405,876
Bausch & Lomb, Inc. ....	56,774	2,235,476
Baxter International, Inc. ....	272,909	16,238,085
BB & T Corp. ....	274,700	8,223,831
Bear Stearns Cos., Inc. ....	107,056	3,312,045
Becton, Dickinson & Co. ....	245,802	10,108,607

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Bell Atlantic Corp. ....	1,539,144	\$ 74,552,287
BellSouth Corp. ....	971,985	73,141,871
Bemis Co., Inc. ....	54,032	1,894,497
Bestfoods ....	278,398	13,484,903
Bethlehem Steel Corp.* ....	116,877	964,235
Biomet, Inc. ....	108,662	3,769,213
Black & Decker Corp. ....	94,273	3,924,114
Block (H&R), Inc. ....	107,034	4,428,532
BMC Software, Inc.* ....	212,600	12,753,874
Boeing Co. ....	999,207	34,285,290
Boise Cascade Corp. ....	52,820	1,337,006
Boston Scientific Corp.* ....	195,877	10,063,181
Briggs & Stratton Corp. ....	23,745	976,513
Bristol-Myers Squibb Co. ....	987,568	102,583,626
Brown-Forman Corp., Class B ....	70,992	4,259,520
Browning-Ferris Industries, Inc. ....	172,460	5,216,915
Brunswick Corp. ....	101,203	1,309,314
Burlington Northern Santa Fe ....	474,728	15,191,296
Burlington Resources, Inc. ....	180,493	6,745,926
Cabletron Systems, Inc.* ....	160,336	1,803,780
Campbell Soup Co. ....	445,438	22,355,420
Capital One Financial Corp. ....	64,582	6,684,237
Cardinal Health, Inc. ....	130,741	13,499,008
Carolina Power & Light Co. ....	142,830	6,596,961
Case Corp. ....	75,414	1,640,255
Caterpillar, Inc. ....	356,434	15,883,590
CBS Corp. ....	710,428	17,227,879
Cendant Corp.* ....	827,176	9,615,921
Centex Corp. ....	60,060	2,072,070
Central & South West Corp. ....	216,820	6,192,921
Ceridian Corp. * ....	72,792	4,176,441
Champion International Corp. ....	98,157	3,073,541
Chase Manhattan Corp. ....	849,520	36,741,740
Chevron Corp. ....	647,223	54,407,183
Chrysler Corp. ....	643,749	30,819,483

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Chubb Corp. . . . .	161,564	\$ 10,178,532
CIGNA Corp. . . . .	208,000	13,754,000
Cincinnati Financial Corp. . . . .	160,129	4,923,967
Cincinnati Milacron, Inc. . . . .	39,644	612,004
CINergy Corp. . . . .	161,167	6,164,638
Circuit City Stores, Inc. . . . .	101,042	3,365,962
Cisco Systems, Inc. * . . . .	1,542,521	95,347,079
Citicorp . . . . .	448,417	41,674,755
Clear Channel Communications * . . . .	248,564	11,806,790
Clorox Co. . . . .	98,059	8,089,867
Coastal Corp. . . . .	215,800	7,283,250
Coca Cola Co. . . . .	2,441,511	140,692,071
Colgate-Palmolive Co. . . . .	291,061	19,937,678
Columbia / HCA Healthcare Corp. . . . .	628,326	12,605,790
Columbia Gas Systems, Inc. . . . .	84,187	4,935,463
Comcast Corp., Class A . . . . .	360,243	16,908,906
Comerica, Inc. . . . .	148,200	8,123,212
Compaq Computer Corp. . . . .	1,648,790	52,142,984
Computer Associates International, Inc. . . . .	537,405	19,883,985
Computer Sciences Corp. . . . .	157,532	8,585,494
ConAgra, Inc. . . . .	474,582	12,784,053
Conseco, Inc. . . . .	307,882	9,409,644
Consolidated Edison, Inc. . . . .	225,423	11,750,174
Consolidated Natural Gas Co. . . . .	97,265	5,300,943
Consolidated Stores Corp.* . . . .	108,363	2,126,624
Cooper Industries, Inc. . . . .	107,717	4,389,468
Cooper Tire & Rubber Co. . . . .	76,098	1,369,764
Coors (Adolph) Co., Class B . . . . .	38,681	1,776,908
Corning, Inc. . . . .	232,886	6,855,582
Costco Cos., Inc. * . . . .	216,613	10,262,041
Countrywide Credit Industries, Inc. . . . .	106,748	4,443,386
Crane Co. . . . .	70,794	1,663,659
Crown Cork & Seal Co., Inc. . . . .	130,221	3,483,412
CSX Corp. . . . .	220,894	9,291,354
Cummins Engine Co., Inc. . . . .	39,326	1,169,949

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
CVS Corp. ....	385,032	\$ 16,869,214
Cyprus Amax Minerals Co. ....	95,992	1,271,894
Dana Corp. ....	162,629	6,068,095
Darden Restaurants, Inc. ....	147,735	2,363,760
Data General Corp. * ....	44,487	483,796
Dayton-Hudson Corp. ....	426,198	15,236,578
Deere & Co. ....	231,933	7,015,973
Dell Computer Corp.* ....	1,257,816	82,701,402
Delta Air Lines, Inc. ....	74,291	7,224,800
Deluxe Corp. ....	83,936	2,386,930
Dillard's, Inc., Class A ....	113,618	3,216,810
Disney (Walt) Co. (The) ....	2,027,002	51,308,488
Dollar General Corp. ....	179,365	4,775,593
Dominion Resources, Inc. ....	189,569	8,459,517
Donnelley (R.R.) & Sons Co. ....	132,706	4,669,592
Dover Corp. ....	225,150	6,951,506
Dow Chemical Co. ....	220,364	18,827,349
Dow Jones & Co., Inc. ....	85,903	3,994,490
DTE Energy Co. ....	136,273	6,157,836
pDu Pont (E.I.) de Nemours & Co., Inc. ....	1,118,807	62,793,043
Duke Power Co. ....	355,021	23,497,952
Dun & Bradstreet Corp. ....	156,375	4,222,125
Eastern Enterprises ....	15,024	632,886
Eastman Chemical Co. ....	79,979	4,033,941
Eastman Kodak Co. ....	316,152	24,442,501
Eaton Corp. ....	69,809	4,376,152
Ecolab, Inc. ....	133,237	3,788,927
Edison International ....	349,588	8,980,042
EG & G, Inc. ....	47,885	1,083,398
Electronic Data Systems Corp. ....	484,084	16,065,538
EMC Corp. * ....	487,317	27,868,441
Emerson Electric Co. ....	435,206	27,091,573
Engelhard Corp. ....	147,793	2,614,089
Enron Corp. ....	321,456	16,976,895
Entergy Corp. ....	243,218	7,478,954

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Equifax, Inc. ....	150,779	\$ 5,380,926
Exxon Corp. ....	2,415,705	169,552,295
Fannie Mae ....	1,027,960	66,046,430
Federal Express Corp. * ....	149,225	6,733,778
Freddie Mac ....	670,438	33,144,779
Federated Department Stores, Inc. * ....	212,304	7,722,558
Fifth Third Bancorp. ....	256,180	14,730,350
First Chicago NBD Corp. ....	282,817	19,372,964
First Data Corp. ....	437,850	10,289,475
First Union Corp. ....	965,534	49,423,272
First Energy Corp. ....	233,559	7,254,926
Fleet Financial Group, Inc. ....	277,906	20,408,722
Fleetwood Enterprises, Inc. ....	36,645	1,106,221
Fluor Corp. ....	69,895	2,870,063
FMC Corp. * ....	37,057	1,910,752
Ford Motor Co. ....	1,204,437	56,533,262
Fort James Corp. ....	214,387	7,034,573
Fortune Brands, Inc. ....	173,390	5,136,679
Foster Wheeler Corp. ....	41,267	567,421
FPL Group, Inc. ....	174,933	12,190,643
Franklin Resources, Inc. ....	249,752	7,492,560
Freeport McMoran Copper & Gold ....	149,868	1,779,683
Frontier Corp. ....	166,554	4,559,416
Fruit of the Loom, Inc.* ....	74,763	1,126,118
Gannett Co., Inc. ....	276,667	14,818,976
Gap, Inc. (The) ....	386,028	20,362,977
Gateway 2000, Inc.* ....	155,854	8,123,890
General Dynamics Corp.. ....	128,240	6,436,045
General Electric Co. ....	3,225,733	256,647,382
General Instrument Corp.. * ....	143,376	3,100,506
General Mills, Inc. ....	148,852	10,419,640
General Motors Corp. ....	643,435	35,187,852
General Reinsurance Corp. ....	75,031	15,231,293
General Signal Corp. ....	48,977	1,662,157
Genuine Parts Co. ....	166,097	4,993,291

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Georgia-Pacific Corp. ....	93,404	\$ 4,261,558
Gillette Co. ....	1,105,542	42,286,981
Golden West Financial Corp. ....	58,342	4,773,105
Goodrich (B.F.) Co. ....	66,576	2,176,203
Goodyear Tire & Rubber Co. (The) ....	159,364	8,187,325
GPU, Inc. ....	124,810	5,304,425
Grace (W. R.) & Co.* ....	73,306	911,743
Grainger (W.W.), Inc. ....	100,250	4,223,031
Great Atlantic & Pacific Tea Co., Inc. ....	38,494	933,480
Great Lakes Chemical Corp. ....	58,635	2,279,436
GTE Corp. ....	954,211	52,481,605
Guidant Corp. ....	151,854	11,275,159
Halliburton Co. ....	440,287	12,575,697
Harcourt General, Inc. ....	72,838	3,523,538
Harnischfeger Industries, Inc. ....	49,727	559,429
Harrahs Entertainment, Inc.* ....	105,063	1,398,651
Harris Corp. ....	80,608	2,579,456
Hartford Financial Services Group ....	224,698	10,659,111
Hasbro, Inc. ....	133,182	3,928,869
HBO & Co. ....	415,092	11,985,781
HCR Manor Care, Inc.* ....	104,452	3,061,749
Healthsouth Corp.* ....	392,394	4,144,662
Heinz (H.J.) Co. ....	362,802	18,548,252
Helmerich & Payne, Inc. ....	51,520	1,081,920
Hercules, Inc. ....	98,430	2,959,052
Hershey Foods Corp. ....	142,185	9,730,786
Hewlett Packard Co. ....	1,029,067	54,476,234
Hilton Hotels Corp. ....	252,348	4,305,688
Home Depot, Inc. (The) ....	1,450,414	57,291,353
Homestake Mining Co. ....	167,623	2,032,429
Honeywell, Inc. ....	121,562	7,787,566
Household International, Inc. ....	488,378	18,314,175
Houston Industries, Inc. ....	284,863	8,866,361
Humana, Inc.* ....	167,404	2,741,241
Huntington Bancshares, Inc. ....	206,406	5,185,951

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Ikon Office Solutions, Inc. ....	134,964	\$ 970,054
Illinois Tool Works, Inc. ....	241,784	13,177,228
IMS Health, Inc. ....	154,522	9,570,706
Inco, Ltd. ....	171,449	1,757,352
Ingersoll Rand Co. ....	164,738	6,249,748
Intel Corp. ....	1,668,685	143,089,739
International Business Machines Corp. ....	926,777	118,627,456
International Flavors & Fragrances, Inc. ....	108,959	3,595,647
International Paper Co. ....	306,911	14,309,725
Interpublic Group of Cos., Inc. ....	128,541	6,933,180
ITT Industries, Inc. ....	121,156	4,104,160
Jefferson-Pilot Corp. ....	99,787	6,037,114
Johnson & Johnson ....	1,334,116	104,394,577
Johnson Controls, Inc. ....	85,670	3,983,655
Jostens, Inc. ....	39,323	815,952
K Mart Corp.* ....	497,325	5,936,817
Kaufman & Broad Home Corp. ....	39,266	920,297
Kellogg Co. ....	393,963	12,976,156
Kerr-McGee Corp. ....	49,139	2,235,825
Keycorp ....	435,676	12,580,144
Kimberly-Clark Corp. ....	535,399	21,683,659
King World Productions, Inc. ....	75,928	1,983,619
Kla-Tencor Corp.* ....	85,862	2,135,817
Knight Ridder, Inc. ....	79,768	3,549,676
Kohls Corp.* ....	157,132	6,128,148
Kroger Co.* ....	258,194	12,909,700
Laidlaw, Inc. ....	328,042	3,095,896
Lehman Brothers Holdings, Inc. ....	118,767	3,355,168
Lilly (Eli) & Co. ....	1,088,872	85,272,288
Limited, Inc. (The) ....	220,813	4,844,085
Lincoln National Corp. ....	95,864	7,884,814
Liz Claiborne, Inc. ....	67,051	1,755,898
Lockheed Martin Corp. ....	195,338	19,692,512
Loews Corp. ....	116,001	9,787,584
Longs Drug Stores Corp. ....	40,059	1,609,871

(\*) Denotes non-income producing security.

See accompanying notes to financial statements



**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Louisiana Pacific Corp. ....	112,498	\$ 2,292,147
Lowes Cos., Inc. ....	349,998	11,134,311
LSI Logic Corp.* ....	140,195	1,769,962
Lucent Technologies, Inc. ....	1,298,870	89,703,209
Mallinckrodt, Inc. ....	75,520	1,534,000
Marriott International, Inc. ....	234,125	5,589,734
Marsh & McLennan Cos., Inc. ....	253,814	12,627,246
Masco Corp. ....	337,000	8,298,625
Mattel, Inc. ....	296,542	8,303,176
May Department Stores Co. ....	232,660	11,981,990
Maytag Corp. ....	83,544	3,989,226
MBIA, Inc. ....	92,492	4,965,664
MBNA Corp. ....	486,221	13,918,076
McDermott International, Inc. ....	58,327	1,571,184
McDonald's Corp. ....	673,924	40,224,839
McGraw-Hill, Inc. ....	99,194	7,861,125
MCI Worldcom, Inc.* ....	1,749,496	85,506,594
Mead Corp. ....	107,270	3,157,761
Mediaone Group, Inc. ....	598,620	26,601,176
Medtronic, Inc. ....	460,181	26,632,975
Mellon Bank Corp. ....	256,991	14,150,567
Mercantile Bancorp, Inc. ....	136,162	6,586,837
Merck & Co., Inc. ....	1,179,521	152,821,690
Meredith Corp. ....	55,449	1,774,368
Merrill Lynch & Co., Inc. ....	339,257	16,072,300
Meyer (Fred), Inc. ....	150,586	5,854,031
MGIC Investment Corp. ....	115,488	4,258,620
Micron Technology, Inc.* ....	214,630	6,532,801
Microsoft Corp.* ....	2,447,412	269,368,283
Millipore Corp. ....	44,391	846,203
Minnesota Mining & Manufacturing Co. ....	399,667	29,450,462
Mirage Resorts, Inc.* ....	179,512	3,006,826
Mobil Corp. ....	776,155	58,939,270
Monsanto Co. ....	587,401	33,114,731
Moore Corp. Ltd. ....	86,292	911,459

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<b>Common Stocks</b>	<b>Shares</b>	<b>Value</b>
Morgan (J.P.) & Co., Inc. ....	175,900	\$ 14,885,537
Morgan Stanley, Dean Witter, Discover and Co. ....	573,727	24,706,119
Morton International, Inc. ....	127,742	2,794,356
Motorola, Inc. ....	590,506	25,207,225
Nacco Industries, Inc., Class A ....	8,435	843,500
Nalco Chemical Co. ....	67,819	2,000,661
National City Corp. ....	323,087	21,303,549
National Semiconductor Corp.* ....	164,726	1,595,783
National Service Industries, Inc. ....	43,724	1,393,703
NationsBank Corp. ....	951,427	50,901,344
Navistar International Corp.* ....	52,218	1,181,432
New York Times Co. (The), Class A ....	176,060	4,841,650
Newell Co. ....	162,484	7,484,419
Newmont Mining Corp. ....	159,749	3,873,913
Nextel Communications, Inc.* ....	267,420	5,398,541
Niagara Mohawk Power Corp.* ....	156,324	2,403,482
NICOR, Inc. ....	50,203	2,080,287
Nike, Inc., Class B ....	276,691	10,185,687
Nordstrom, Inc. ....	155,540	3,849,615
Norfolk Southern Corp. ....	381,911	11,099,288
Northern States Power Co. ....	147,664	4,143,821
Northern Telecom Ltd. ....	640,664	20,501,248
Northern Trust Corp. ....	112,673	7,689,932
Northrop Corp. ....	67,186	4,904,578
Norwest Corp. ....	744,039	26,645,897
Novell, Inc.* ....	355,476	4,354,581
Nucor Corp. ....	90,365	3,671,078
Occidental Petroleum Corp. ....	345,566	7,429,669
Omnicom Group Inc. ....	166,194	7,478,730
ONEOK, Inc. ....	30,038	1,021,292
Oracle Systems Corp.* ....	955,247	27,821,569
Oryx Energy Co.* ....	107,919	1,396,202
Owens Corning ....	54,077	1,760,882
Owens-Illinois, Inc.* ....	153,886	3,847,150
P P & L Resources, Inc. ....	136,691	3,536,880

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
PACCAR, Inc. ....	80,003	\$ 3,295,124
PacifiCorp ....	301,388	5,782,882
Pall Corp. ....	125,092	2,775,479
Parametric Technology Corp.* ....	263,660	2,653,079
Parker-Hannifin Corp. ....	114,356	3,394,944
Paychex, Inc. ....	168,100	8,601,677
Peco Energy Co. ....	211,241	7,723,499
Penney (J.C.) Co., Inc. ....	252,188	11,332,698
Pennzoil Co. ....	47,940	1,680,896
Peoples Energy Corp. ....	36,377	1,309,572
Pep Boys-Manny Moe & Jack ....	64,381	861,096
PepsiCo, Inc. ....	1,450,791	42,707,660
Perkin-Elmer Corp. ....	46,298	3,180,094
Pfizer, Inc. ....	1,295,811	137,274,978
PG&E Corp. ....	376,602	12,027,726
Pharmacia & Upjohn, Inc. ....	498,115	24,999,147
Phelps Dodge Corp. ....	59,077	3,083,081
Philip Morris Cos., Inc. ....	2,413,438	111,168,988
Phillips Petroleum Co. ....	250,710	11,313,289
Pioneer Hi Bred International, Inc. ....	236,998	6,221,198
Pitney Bowes, Inc. ....	270,379	14,211,796
Placer Dome, Inc. ....	247,219	3,414,712
PNC Financial Corp. ....	293,020	13,185,900
Polaroid Corp. ....	46,206	1,134,935
Potlatch Corp. ....	29,959	1,020,478
PPG Industries, Inc. ....	169,602	9,253,909
Praxair, Inc. ....	161,003	5,262,786
Procter & Gamble Co. ....	1,327,068	94,138,886
Progressive Corp. ....	72,320	8,154,080
Provident Cos., Inc. ....	134,640	4,544,100
Providian Financial Corp. ....	96,461	8,181,099
Public Service Enterprise, Inc. ....	221,502	8,707,797
Pulte Corp. ....	45,010	1,105,558
Quaker Oats Co. ....	129,579	7,645,161
Ralston Purina Co. ....	304,846	8,916,745

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Raychem Corp. ....	77,249	\$ 1,882,944
Raytheon Co. ....	338,795	18,273,755
Reebok International Ltd.* ....	57,420	778,759
Regions Financial Corp. ....	210,032	7,613,660
Republic New York Corp. ....	110,526	4,365,777
Reynolds Metals Co. ....	74,358	3,778,316
Rite Aid Corp. ....	254,732	9,042,986
RJR Nabisco, Inc. ....	315,320	7,942,123
Rockwell International Corp. ....	180,700	6,527,788
Rohm & Haas Co. ....	174,045	4,840,627
Rowan Cos., Inc. * ....	88,484	989,915
Royal Dutch Petroleum Co. ....	2,121,600	101,041,200
Rubbermaid, Inc. ....	154,294	3,693,413
Russell Corp. ....	38,351	1,006,714
Ryder Systems, Inc. ....	77,603	1,930,375
SAFECO Corp. ....	135,348	5,642,320
Sara Lee Corp. ....	457,692	24,715,368
SBC Communications, Inc. ....	1,822,934	81,006,630
Schering-Plough Corp. ....	724,581	75,039,420
Schlumberger Ltd. ....	538,984	27,117,632
Schwab (Charles) Corp. ....	269,649	10,617,429
Scientific-Atlanta, Inc. ....	79,945	1,688,838
Seagate Technology, Inc.* ....	248,825	6,236,177
Seagram Co. Ltd. (The) ....	337,038	9,668,778
Sealed Air Corp. * ....	81,383	2,594,077
Sears, Roebuck & Co. ....	383,224	16,933,710
Sempra Energy ....	225,525	5,877,745
Service Corp. International ....	250,540	7,985,962
Shared Medical System ....	25,328	1,347,133
Sherwin-Williams Co. ....	176,005	3,806,108
Sigma Aldrich Corp. ....	103,204	2,980,016
Silicon Graphics, Inc. * ....	180,490	1,692,094
SLM Holding Corp. ....	167,486	5,432,827
Snap On, Inc. ....	62,308	1,919,865
Sonat, Inc. ....	110,950	3,314,631

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Southern Co. . . . .	697,685	\$ 20,538,102
Southwest Airlines Co. . . . .	337,369	6,747,380
Springs Industries, Inc. . . . .	20,124	699,309
Sprint Corp. . . . .	425,190	30,613,680
St. Jude Medical Center, Inc. * . . . .	87,126	2,014,789
St. Paul Cos., Inc. . . . .	233,008	7,572,760
Stanley Works (The) . . . . .	90,341	2,687,645
State Street Corp. . . . .	163,594	8,926,098
Stone Container Corp. * . . . .	101,365	874,273
Summit Bancorp. . . . .	163,746	6,140,475
Sun Co., Inc. . . . .	79,872	2,555,904
Sun Microsystems, Inc. * . . . .	375,734	18,716,250
SunAmerica, Inc. . . . .	190,841	11,641,301
Suntrust Banks, Inc. . . . .	201,866	12,515,692
Supervalu, Inc. . . . .	114,384	2,666,577
Synovus Financial Corp. . . . .	264,950	5,232,763
Sysco Corp. . . . .	333,444	7,856,774
Tandy Corp. . . . .	93,310	4,992,085
Tektronix, Inc. . . . .	51,326	795,553
Tele-Communications, Inc.* . . . .	518,701	20,294,177
Tellabs, Inc. * . . . .	185,575	7,388,205
Temple-Inland, Inc. . . . .	57,288	2,742,663
Tenet Healthcare Corp. * . . . .	307,918	8,852,642
Tenneco, Inc. . . . .	158,457	5,209,274
Texaco, Inc. . . . .	534,760	33,522,767
Texas Instruments, Inc. . . . .	390,219	20,584,052
Texas Utilities Co. . . . .	270,243	12,583,190
Textron, Inc. . . . .	164,962	10,000,821
Thermo Electron Corp. * . . . .	155,479	2,341,902
Thomas & Betts Corp. . . . .	55,426	2,109,652
Time Warner, Inc. . . . .	586,085	51,319,068
Times Mirror Co., Class . A . . . . .	85,212	4,526,888
Timken Co. . . . .	65,018	983,397
TJX Cos., Inc. (The) . . . . .	318,986	5,681,938
Torchmark Corp. . . . .	142,919	5,136,152

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Toys R Us Co. *	253,215	\$ 4,098,918
Transamerica Corp.	62,020	6,574,120
Travelers, Inc.	1,139,950	42,748,125
Tribune Co.	123,332	6,205,141
Tricon Global Restaurants, Inc. *	155,072	6,047,808
TRW, Inc.	124,587	5,528,548
Tupperware Corp.	63,426	745,256
Tyco Laboratories, Inc.	579,601	32,022,955
U. S. West, Inc.	491,589	25,777,698
U.S. Bancorp.	733,982	26,102,235
U.S. Surgical Corp.	70,785	2,950,850
Unicom Corp.	206,185	7,706,1. 64
Unilever N. V. (N.Y. shares)	630,486	38,617,267
Union Camp Corp.	70,755	2,785,978
Union Carbide Corp.	126,856	5,470,665
Union Pacific Corp.	238,178	10,152,337
Union Pacific Resources Group, Inc.	257,062	3,165,076
Union Planters Corp.	131,000	6,582,750
Unisys Corp. *	251,834	5,729,224
United Healthcare Corp.	191,721	6,710,235
United Technologies Corp.	223,909	17,115,044
Unocal Corp.	223,369	8,097,126
Unum Corp.	130,632	6,490,778
USAir Group, Inc. *	86,999	4,404,324
UST, Inc.	189,298	5,596,122
USX-Marathon Group.	291,415	10,327,019
USX-U.S. Steel Group	87,474	2,088,442
V.F. Corp.	123,319	4,578,218
Venator Group, Inc. *	137,995	1,198,832
Viacom, Inc. *	356,627	20,684,366
Wachovia Corp.	204,280	17,414,870
Wal-Mart Stores, Inc.	2,213,354	120,904,462
Walgreen Co.	477,929	21,058,747
Warner-Lambert Co.	809,004	61,079,802
Washington Mutual, Inc.	384,498	12,976,807

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

**SPDR Trust Series 1**  
**Schedule of Investments (continued)**  
**September 30, 1998**

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
Waste Management, Inc. ....	555,597	\$ 26,703,381
Wells Fargo & Co. ....	84,187	29,886,385
Wendy's International, Inc. ....	133,234	2,956,129
Westvaco Corp. ....	104,196	2,500,704
Weyerhaeuser Co. ....	189,763	8,005,627
Whirlpool Corp. ....	76,698	3,604,806
Willamette Industries, Inc. ....	113,151	3,246,019
Williams Cos., Inc. (The) ....	418,524	12,032,565
Winn-Dixie Stores, Inc. ....	148,856	5,535,583
Worthington Industries, Inc. ....	96,922	1,211,525
Wrigley (Wm) Jr. Co. ....	116,815	8,870,639
Xerox Corp. ....	322,959	27,370,775
Total Investments—(Cost \$8,705,757,098) ....		<u>\$8,052,798,893</u>

(\*) Denotes non-income producing security.

See accompanying notes to financial statements

## **PROSPECTUS SUMMARY**

The following summary is qualified in its entirety by the more detailed information appearing elsewhere in Part B of this Prospectus.

### **Objectives**

The Sponsor formed the Trust to provide investors with the opportunity to purchase units of beneficial interest in the Trust representing proportionate undivided interests in the Securities which consist of substantially all of the common stocks, in substantially the same weighting, as the component common stocks of the Standard & Poor's 500 Composite Stock Price Index (the "S&P 500 Index") in the form of a security that closely tracks the S&P 500 Index and that may be traded as a share of common stock. The investment objective of the Trust is to provide investment results that, before expenses, generally correspond to the price and yield performance of the component common stocks of the S&P 500 Index (the "Index Securities"). There can be no assurance that this investment objective will be met fully. For example, it will not be possible for the Trust to replicate and maintain exactly the composition and relative weightings of the Index Securities. It is also possible that, from time to time, the Trust will be unable to purchase all of the Index Securities. In certain circumstances, the Trust may be required to make distributions in excess of the yield performance of the Index Securities (see "Tax Status of the Trust"). The value of the Securities and, consequently, the value of SPDRs, is subject to changes in the value of common stocks generally and to other factors. Further, the payment of dividends and maintenance of capital are subject to a number of conditions, including the financial condition of the issuers of the Securities (See "Special Considerations and Risk Factors").

### **The Trust**

The Trust is a unit investment trust organized under the laws of the State of New York. The Trust is governed by a trust agreement (the "Trust Agreement") between State Street Bank and Trust Company, a bank and trust company organized under the laws of the Commonwealth of Massachusetts (the "Trustee"), and the Sponsor dated and executed as of January 22, 1993.

### **Distributor**

The Distributor for SPDRs is ALPS Mutual Funds Services, Inc., a registered broker-dealer and a member of the National Association of Securities Dealers, Inc. (see "Underwriting").



### Portfolio Deposits

All orders to create SPDRs in Creation Unit size aggregations must be placed with the Distributor (see "Underwriting" and "Procedure for Creation of Creation Units"). To be eligible to place orders with the Distributor to create Creation Unit size aggregations of SPDRs, an entity or person either must be (1) a "Participating Party", as hereinafter defined or (2) a Depository Trust Company Participant (see "Book-Entry Ownership of SPDRs"), and in each case must have executed a Participant Agreement, as hereinafter defined (see "The Trust—Procedures for Creation of Creation Units" and "The Trust—Placement of Creation Orders Using SPDR Clearing Process"). As used herein, the term "Participating Party" means a broker-dealer or other participant in the SPDR Clearing Process, as hereinafter defined, through the Continuous Net Settlement ("CNS") System of the National Securities Clearing Corporation ("NSCC"), a clearing agency that is registered with the Securities and Exchange Commission (the "Commission"). Upon acceptance of an order to create SPDRs, the Distributor will transmit such order to the Trustee and instruct the Trustee to initiate the book entry movement of the appropriate number of SPDRs to the account of the entity placing the order. Payment for orders to create SPDRs will be made by deposits with the Trustee of a portfolio of securities that is substantially similar in composition and weighting to the Index Securities (see "The Trust—Creation of SPDRs"), together with a cash payment in an amount which shall be equal to the Dividend Equivalent Payment (as hereinafter defined), plus or minus, as the case may be, the Balancing Amount (as hereinafter defined—see "The Portfolio— Adjustments to the Portfolio Deposit"). The "Dividend Equivalent Payment" enables the Trustee to make a distribution of dividends on the next Dividend Payment Date (as hereinafter defined), and is an amount equal, on a per Creation Unit basis, to the dividends on all the Securities with ex-dividend dates within the accumulation period, net of expenses and accrued liabilities for such period (including, without limitation, (x) taxes or other governmental charges against the Trust not previously deducted, if any, and (y) accrued fees of the Trustee and other expenses of the Trust (including legal and auditing expenses) and other expenses not previously deducted (see "Expenses of the Trust")), as if all of the Securities had been held for the entire accumulation period for such distribution. For federal income tax purposes, a portion of dividend distributions may result in a return of capital to Beneficial Owners (as hereinafter defined) of SPDRs (see "Tax Status of the Trust").

The Dividend Equivalent Payment and the Balancing Amount are collectively referred to herein as the "Cash Component" and the deposit of such

a portfolio of securities and the Cash Component are collectively referred to herein as a "Portfolio Deposit". In connection with the creation of SPDRs, in the event that the Trustee determines, in its discretion, that one or more Index Securities are likely to be unavailable for delivery or available in insufficient quantity for delivery to the Trust upon the creation of SPDRs in Creation Unit size aggregations, then the Trustee shall have the right in its discretion to permit the cash equivalent value of such Index Security or Index Securities to be included in the Portfolio Deposit as a part of the Cash Component in lieu of the inclusion of such Index Security or Index Securities in the securities portion of the Portfolio Deposit (see "The Portfolio—Adjustments to the Portfolio Deposit").

In connection with the creation of SPDRs, if a creator is restricted by regulation or otherwise from investing or engaging in a transaction in one or more Index Securities, the Trustee shall have the right, in its discretion, to permit the cash equivalent value of such Index Security or Index Securities to be included in the Portfolio Deposit based on the market value of such Index Security or Index Securities as of the Evaluation Time on the date such creation order is deemed received by the Distributor (see "Placement of Creation Orders Outside SPDR Clearing Process") as part of the Cash Component in lieu of the inclusion of such Index Security or Index Securities in the securities portion of the Portfolio Deposit. In such case such creator will pay the Trustee the standard Transaction Fee, plus an additional amount per Creation Unit not to exceed three (3) times the Transaction Fee applicable for one Creation Unit as described below.

An entity or person placing creation orders with the Distributor must deposit Portfolio Deposits either (i) through the CNS clearing processes of NSCC, as such processes have been enhanced to effect creations and redemptions of Creation Unit size aggregations of SPDRs, such processes being referred to herein as the "SPDR Clearing Process", or (ii) with the Trustee outside the SPDR Clearing Process (*i.e.*, through the facilities of DTC).

#### **Transaction Fee**

A transaction fee is payable to the Trustee in connection with each creation and each redemption made through the SPDR Clearing Process of Creation Unit size aggregations of SPDRs (the "Transaction Fee"), subject to the changes, modifications or waivers, if any, described below. Such Transaction Fee is non-refundable, regardless of the net asset value of the Trust.

Until further notice is given as described below, the Transaction Fee charged in connection with each creation or redemption of Creation Units through the SPDR Clearing Process is \$3,000 per Participating Party per day, regardless of the number of Creation Units created or redeemed on such day (see "Procedures for Creation of Creation Units" and "Procedure for Redemption of SPDRs"). This \$3,000 charge is subject to a limit not to exceed 10/100 of one percent (10 basis points) of the value of one Creation Unit at the time of creation (the "10 Basis Point Limit")\*. No modifications to, or reductions, discounts or waivers of, the Transaction Fee charged in connection with the creation or redemption of Creation Units are scheduled or currently contemplated by the Sponsor.

If Creation Units are created or redeemed outside the SPDR Clearing Process, an additional amount not to exceed three (3) times the Transaction Fee applicable for one Creation Unit will be charged to the creator or redeemer per Creation Unit per day. Under the current schedule, therefore, the total fee charged in connection with the creation or redemption of one Creation Unit outside the SPDR Clearing Process would be \$3,000 (the Transaction Fee for the creation or redemption of one Creation Unit) plus an additional amount up to \$9,000 ((3) times \$3,000) for a total not to exceed \$12,000.

From time to time, and for such periods as the Sponsor, in its sole discretion, may determine, the Transaction Fee (as well as any additional amounts charged in connection with creations and/or redemptions outside the SPDR Clearing Process) may be increased, decreased or otherwise modified or waived in its entirety for certain lot-size creations and/or redemptions of SPDRs, or for creations and/or redemptions made under certain specified circumstances without the consent of Beneficial Owners, subject to certain conditions (See "The Trust—Creation of Creation Units" and "Procedures for Redemption of SPDRs"). The Sponsor also reserves the right, from time to time, to vary the lot-size of the creations and/or redemptions of SPDRs subject to an increase or decrease and/or entitled to such waiver of the Transaction Fee. Any change so made will not cause the amount of the Transaction Fee to exceed the 10 Basis Point Limit at the time of a creation, or redemption, as the case may be. Such changes or variations will be effected by an amendment to the current Trust prospectus. The amount of the new Transaction Fee in effect at any given time will be available from the Trustee.

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\* The amount of the Transaction Fee currently in effect will be available from the Trustee.

### **Size of Creation Unit Aggregations of SPDRs**

SPDRs may be created or redeemed only in Creation Unit size aggregations of 50,000 SPDRs, or in multiples thereof (e.g., 100,000, 150,000, 200,000 SPDRs), and in no event will fractional Creation Units be created or redeemed.\* The Sponsor reserves the right to direct the Trustee to declare a split or reverse split in the number of SPDRs outstanding and a corresponding change in the number of SPDRs constituting a Creation Unit in the event that the per SPDR price in the secondary market changes to an amount that the Sponsor believes falls outside a desirable retail range. For example, if a 2-for-1 split were declared, the number of SPDRs in a Creation Unit size aggregation of SPDRs would double (e.g., from 50,000 to 100,000 SPDRs per Creation Unit).

### **Portfolio Adjustments**

To maintain the correspondence between the composition and weighting of Securities and that of the Index Securities, the composition and weightings of the Securities are adjusted from time to time to conform to periodic changes in the identity and/or relative weightings of the Index Securities made by Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("Standard & Poor's" or "S&P"). The Trustee aggregates certain of these adjustments and makes conforming changes to the Trust's portfolio at least monthly; adjustments are made more frequently, however, in the case of changes to the S&P 500 Index that are significant (see "The Portfolio—Adjustments to the Portfolio"). The composition and weightings of the securities portion of a Portfolio Deposit are also adjusted to conform to changes in the S&P 500 Index. Any change in the identity or weighting of an Index Security will result in a corresponding adjustment to the prescribed Portfolio Deposit effective on the Business Day (a "Business Day" being any day that the New York Stock Exchange is open for business) following the day on which the change to the S&P 500 Index takes effect after the close of the market (see "The Portfolio—Adjustments to the Portfolio Deposit").

### **Book Entry Ownership of SPDRs**

The Depository Trust Company, New York, New York, a limited purpose trust company organized under the laws of the State of New York (the "Depository") or its nominee will be the record or registered owner of all

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\* See "Dividend Reinvestment Service," however, for a description of the sole case in which SPDRs may be created by the Trustee in less than a Creation Unit size aggregation of 50,000 SPDRs.

outstanding SPDRs. Beneficial ownership of SPDRs will be shown on the records of the Depository or its participants. Certificates will not be issued for SPDRs, whether in Creation Unit size aggregations or otherwise (see "The Trust—Book-Entry-Only System").

#### **Expenses**

The expenses incident to the organization of the Trust and its registration as an investment company were capitalized and have been amortized on a straight line basis over five years following the Initial Date of Deposit. The Trustee's fees are set forth generally in the Summary of Essential Information and more specifically in "Expenses of the Trust" below. Other expenses of the Trust are also described more fully in "Expenses of the Trust".

#### **Federal Income Tax Considerations**

For the fiscal year ended September 30, 1998, the Trust believes that it qualified for tax treatment as a "regulated investment company" under Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"). The Trust intends to continue to so qualify and to distribute annually its entire investment company taxable income and net capital gain. Distributions that are taxable as ordinary income to Beneficial Owners generally are expected to constitute dividend income for federal income tax purposes and to be eligible for the dividends-received deduction available to many corporations to the extent of qualifying dividend income received by the Trust (see "Tax Status of the Trust"). The Trust's regular quarterly distributions are based on the dividend performance of the Securities held during such quarterly distribution period rather than the actual taxable income of the Trust. As a result, a portion of the distributions of the Trust may be treated as a return of capital or a capital gain dividend for federal income tax purposes or the Trust may be required to make additional distributions to maintain its status as a regulated investment company or to avoid imposition of income or excise taxes on undistributed income (see "Tax Status of the Trust" and "Administration of the Trust—Distributions to Beneficial Owners").

#### **ERISA Considerations**

In considering the advisability of an investment in SPDRs, fiduciaries of pension, profit sharing or other tax-qualified retirement plans (including Keogh Plans) and welfare plans (collectively, "Plans") subject to the fiduciary responsibility requirements of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), should consider whether an investment in

SPDRs is permitted by the documents and instruments governing the Plan and whether the investment satisfies the diversification requirements of ERISA. Individual retirement account ("IRA") investors should consider that an IRA may make only such investments as are authorized by its governing instruments.

The fiduciary standards and prohibited transaction rules of ERISA and Section 4975 of the Code will not apply to transactions involving the Trust's assets while SPDRs are held by a Plan or IRA. Unlike many other investment vehicles offered to Plans and IRAs, the Trust's assets will not be treated as "plan assets" of the Plans or IRAs which acquire or purchase SPDRs. Although ERISA imposes certain duties on Plan fiduciaries and ERISA and/or Section 4975 of the Code prohibit certain transactions involving "plan assets" between Plans or IRAs and their fiduciaries or certain related persons, those rules will not apply to transactions involving the Trust's assets because SPDRs represent an interest in the Trust, and the Trust is registered as an investment company under the Investment Company Act of 1940, as amended (the "1940 Act"). ERISA, the Code and U.S. Department of Labor regulations contain unconditional language exempting the assets of registered investment companies from treatment as "plan assets" in applying the fiduciary and prohibited transaction provisions of ERISA and the Code.

#### **Restrictions on Purchases by Investment Companies**

The acquisition of SPDRs by registered investment companies is subject to the restrictions set forth in section 12(d)(1) of the 1940 Act.

#### **Investment Management**

The Trust holds the Securities and cash and is not actively "managed" by traditional methods, which typically involve effecting changes in the Securities on the basis of judgments made relating to economic, financial and market considerations. The composition and relative weightings of the Securities are, however, adjusted to conform to changes in the composition and weighting of the Index Securities in the manner set forth in the Trust Agreement (see "The Portfolio—Adjustments to the Portfolio").

#### **Distributions**

Quarterly distributions based on the amount of dividends payable with respect to Securities held by the Trust and other income, if any, received by the Trust, net of fees and expenses, are made via the Depository and its participants to Beneficial Owners (see "The Trust—Book-Entry-Only System") on each

Dividend Payment Date (see "Administration of the Trust—Distributions to Beneficial Owners"). Any capital gain income recognized by the Trust in any taxable year that is not previously treated as distributed during the year ordinarily is to be distributed at least annually in January of the following taxable year. The Trust may make additional distributions shortly after the end of the year in order to satisfy certain distribution requirements imposed by the Code (see "Tax Status of the Trust" and "Administration of the Trust—Distributions to Beneficial Owners"). Although all distributions are currently made quarterly, the Trustee reserves the right to vary the periodicity with which distributions are made (see "Administration of the Trust—Distributions to Beneficial Owners"). Those Beneficial Owners interested in reinvesting their quarterly distributions may participate through DTC Participants in the DTC Dividend Reinvestment Service available through certain brokers. (See "Dividend Reinvestment Service" for a brief description thereof.)

### **Redemption**

SPDRs in Creation Unit size aggregations are redeemable in kind only and are not redeemable for cash (see "Redemption of SPDRs"). SPDRs can be redeemed only in Creation Unit size aggregations effected by a Participating Party (with respect to redemptions through the SPDR Clearing Process) or a DTC Participant (with respect to redemptions outside the SPDR Clearing Process), in either case which has executed a Participant Agreement (see "Redemption of SPDRs—Procedure for Redemption of SPDRs"). Individual SPDRs are not redeemable, but entitle the owners thereof to certain payments upon termination of the Trust (see "Administration of the Trust—Termination"). Prior to termination, SPDR owners may aggregate individual SPDRs to Creation Unit size or multiples thereof (*e.g.*, 50,000, 100,000 SPDRs, etc.) and request that the Trustee redeem the SPDRs so aggregated. There can be no assurance, however, that there always will be sufficient depth and liquidity in the public trading market to complete all such transactions (see "Special Considerations"). Owners of SPDRs in less than Creation Unit size aggregations may have to pay brokerage fees and commissions to acquire sufficient SPDRs (*i.e.*, 50,000 SPDRs) to constitute a Creation Unit. Each redemption will also be accompanied by a Cash Redemption Payment (as hereinafter defined, see "Redemption of SPDRs—Procedure for Redemption of SPDRs") which on any given Business Day is an amount identical to the Cash Component of a Portfolio Deposit.

In the event that the Trustee determines in its discretion that an Index Security is likely to be unavailable for delivery or available in insufficient

quantity for delivery by the Trust upon the redemption of SPDRs in Creation Unit size aggregations, then the Trustee shall have the right in its discretion to deliver the cash equivalent value of such Index Security or Index Securities, based on the market value of such Index Security or Index Securities as of the Evaluation Time on the date such redemption order is deemed received by the Trustee (see "Procedure for Redemption of SPDRs"), as part of the Cash Redemption Payment in lieu of delivering the Index Security or Index Securities to the redeemer.

In connection with the redemption of SPDRs, if a redeemer is restricted by regulation or otherwise from investing or engaging in a transaction in one or more Index Securities, the Trustee shall have the right in its discretion to deliver the cash equivalent value of such Index Security or Index Securities based on the market value of such Index Security or Index Securities as of the Evaluation Time on the date such redemption order is deemed received by the Trustee (see "Placement of Redemption Orders Outside SPDR Clearing Process") as a part of the Cash Redemption Payment in lieu of delivering such Index Security or Index Securities to the redeemer. In such case, such investor will pay the Trustee the Standard Transaction Fee, plus an additional amount per Creation Unit not to exceed three (3) times the Transaction Fee applicable for one Creation Unit.

SPDR owners may also be required to pay Excess Cash Amounts, (as hereinafter defined) when applicable, in connection with a redemption of SPDRs (see "Redemption of SPDRs—Procedure for Redemption of SPDRs"). The Transaction Fee will be charged in connection with the redemption of each Creation Unit size aggregation of SPDRs. If a request for redemption is made directly to the Trustee outside the SPDR Clearing Process, an additional amount not to exceed three (3) times the Transaction Fee applicable for one Creation Unit will be charged to the redeemer due to the increased expense associated with delivery outside the SPDR Clearing Process (see "Prospectus Summary—Transaction Fee").

#### **Termination**

The Trust will terminate by its terms on the first to occur of: (i) the date one hundred twenty-five (125) years from the Initial Date of Deposit (*i.e.*, January 22, 2118) or (ii) the date twenty (20) years after the death of the last survivor of eleven persons named in the Agreement, the oldest of whom was born in 1990 and the youngest of whom was born in 1993 (the "Termination Date"). The Trust may also be terminated earlier upon the agreement of the Beneficial Owners of 66⅔% of the then outstanding SPDRs or in the event that SPDRs are delisted from the Exchange (see "Exchange Listing"). The Sponsor



will also have the discretionary right to terminate the Trust if at any time the net asset value of the Trust is less than \$350,000,000, as such dollar amount shall be adjusted for inflation in accordance with the National Consumer Price Index for All Urban Consumers (the "CPI-U")\* as published by the United States Department of Labor, such adjustment to take effect at the end of the fourth year following the Initial Date of Deposit and at the end of each year thereafter and to be made so as to reflect the percentage increase in consumer prices as set forth in the CPI-U for the twelve month period ending in the month preceding the month in which such adjustment is made. The Trustee shall also have the right to terminate the Trust in the event that (a) the Sponsor resigns or becomes incapable of discharging its duties and a successor is not appointed; (b) the Depository is unable or unwilling to continue to perform its functions as set forth under the Trust Agreement and a comparable replacement is unavailable; (c) NSCC no longer provides clearance services with respect to SPDRs, or if the Trustee is no longer a member of NSCC; (d) Standard & Poor's ceases publishing the S&P 500 Index; or (e) the License Agreement (as hereinafter defined) is terminated. The License Agreement currently is scheduled to expire on January 22, 2018. The Trust shall also terminate if the Trustee resigns or becomes incapable of discharging its duties and a successor is not appointed (see "Administration of the Trust—Termination").

#### **Underwriting**

ALPS Mutual Funds Services, Inc., (the "Distributor") acts as underwriter of SPDRs on an agency basis. All orders to create SPDRs in Creation Unit size aggregations must be placed with the Distributor, and it is the responsibility of the Distributor to transmit such orders to the Trustee. The Distributor will furnish to those placing such orders confirmation that the orders have been accepted, but the Distributor shall reject any order which is not submitted in proper form. Upon acceptance of an order to create SPDRs, the Distributor instructs the Trustee to initiate the book-entry movement of the appropriate number of SPDRs to the account of the entity placing the order. The Distributor is also responsible for delivering a prospectus to those persons creating SPDRs. The Distributor also maintains records of both the orders placed with it for the creation of SPDRs and the confirmations of acceptance issued by it. In addition, the Distributor maintains a record of the instructions given to implement delivery of SPDRs in response to orders placed with it. The Distributor may also

\* The CPI-U, as published by the United States Department of Labor, measures the inflation rate of specified commodities deemed representative of the purchases of all urban consumers.

provide certain other administrative services, such as those related to state securities law compliance. The Distributor is a corporation organized under the laws of the State of Colorado and is located at 370 17th Street, Suite 3100, Denver, CO 80202. The Distributor is a registered broker-dealer and a member of the National Association of Securities Dealers, Inc. The Sponsor pays the Distributor for its services a flat annual fee. The Sponsor will not seek reimbursement for such payment from the Trust without obtaining prior exemptive relief from the Commission.

## RISK FACTORS AND SPECIAL CONSIDERATIONS

### General

Investment in the Trust should be made with an understanding that the value of the Securities may fluctuate in accordance with changes in the financial condition of the issuers of the Securities (particularly those that are heavily weighted in the S&P 500 Index), the value of common stocks generally and other factors. The identity and weighting of the Index Securities and the Securities also changes from time to time (see “The Portfolio—Adjustments to the Portfolio” and “The Portfolio—Selection and Acquisition of Securities”). There can be no assurance that the issuers of the Securities will pay dividends on outstanding shares of common stock. Distributions on the Securities will generally depend upon the declaration of dividends by the issuers of the Securities; the declaration of such dividends generally depends upon various factors, including the financial condition of the issuers and general economic conditions. As discussed above, the Trust, unlike a managed investment company, is not actively “managed” by traditional methods, and therefore the adverse financial condition of an issuer will not result in the elimination of its securities from the Securities held by the Trust unless the Securities of such issuer are removed from the S&P 500 Index (see “The Portfolio—Adjustments to the Portfolio”).

An investment in the Trust should also be made with an understanding of the risks inherent in an investment in equity securities, including the risk that the financial condition of the issuers of the Securities may become impaired or that the general condition of the stock market may deteriorate (either of which may cause a decrease in the value of the Securities and thus in the value of SPDRs). Common stocks are susceptible to general stock market fluctuations and to volatile increases and decreases in value as market confidence in and perceptions of their issuers change. These investor perceptions are based on various and unpredictable factors including expectations regarding government, economic, monetary and fiscal policies, inflation and interest rates, economic expansion or contraction, and global or regional political, economic and banking crises. As discussed above, the Trust is not actively “managed” and therefore common stocks held by the Trust will not be disposed of as a result of normal fluctuations in the market.

Holders of common stocks of any given issuer incur more risk than holders of preferred stocks and debt obligations of such issuer because common stockholders, as owners of such issuer, have generally inferior rights to receive payments from such issuer in comparison with the rights of creditors of, or holders of debt obligations or preferred stocks issued by, such issuer. Further, unlike debt securities which typically have a stated principal amount payable at maturity (whose value, however, will be subject to market fluctuations prior thereto), or preferred stocks which typically have a liquidation preference and which may have stated optional or mandatory redemption provisions, common stocks have neither a fixed principal amount nor a maturity.

Common stock values are subject to market fluctuations as long as the common stock remains outstanding. The value of the Securities thus may be expected to fluctuate over the entire life of the Trust to values higher or lower than those prevailing on the Initial Date of Deposit (see “Market Risks”).

Although most of the Securities are listed on a national securities exchange, the principal trading market for some Securities may be in the over-the-counter market. The existence of a liquid trading market for certain Securities may depend on whether dealers will make a market in such Securities. There can be no assurance that a market will be made for any of the Securities, that any market for the Securities will be maintained or that any such market will be or remain liquid. The price at which the Securities may be sold and the value of the Trust will be adversely affected if trading markets for the Securities are limited or absent.

An investment in the Trust should also be made with an understanding that the Trust will not be able to replicate exactly the performance of the S&P 500 Index because the total return generated by the Securities will be reduced by transaction costs incurred in adjusting the actual balance of the Portfolio Securities and other Trust expenses, whereas such transaction costs and expenses are not included in the calculation of the S&P 500 Index. It is also possible that for a short period of time, the Trust may not fully replicate the performance of the S&P 500 Index due to the temporary unavailability of certain Index Securities in the secondary market or due to other extraordinary circumstances. Such events are unlikely to continue for an extended period of time, because the Trustee is required to correct such imbalances by means of adjusting the composition or weighting of Portfolio Securities (see “The Portfolio—Adjustments to the Portfolio”).

Neither the Depository nor Beneficial Owners of SPDRs are entitled either to dispose of any of the Securities in the Trust, as such, or to vote the Securities. As the beneficial owner of the Securities, the Trustee has the right to vote all of the voting Securities (see “Administration of the Trust—Voting”).

Except as otherwise specifically noted, the time frames for delivery of securities, cash, or SPDRs in connection with creation and redemption activity within the SPDR Clearing Process as set forth herein are based on NSCC’s current “regular way” settlement period of three (3) days during which NSCC is open for business (each such day an “NSCC Business Day”). NSCC may, in the future, reduce such “regular way” settlement period, in which case it is anticipated that there would be a corresponding reduction in settlement periods applicable to SPDR creations and redemptions. Investors should note that NSCC Business Days do not always coincide with the days during which the Trustee is open for business.

### **Net Asset Value and Market Prices**

The Trust's assets consist primarily of the Securities. Therefore, the net asset value of SPDRs in Creation Unit size aggregations and, proportionately, the net asset value per SPDR, changes as fluctuations occur in the market value of Securities. Investors should also be aware that the aggregate public trading market price of 50,000 SPDRs may be different from the net asset value of a Creation Unit aggregation of SPDRs (*i.e.*, 50,000 SPDRs may trade at a premium over or at a discount to the net asset value of a Creation Unit) and similarly the public trading market price per SPDR may be different from the net asset value of a Creation Unit on a per SPDR basis (see "Special Considerations and Risk Factors—Market Risks"). This price difference may be due, in large part, to the fact that supply and demand forces at work in the secondary trading market for SPDRs will be closely related to, but not identical to, the same forces influencing the prices of the S&P 500 Index stocks trading individually or in the aggregate at any point in time. The expenses of the Trust are reflected in the net asset value of SPDRs in Creation Unit size aggregations and the expenses of the Trust are accrued daily (see "Expenses of the Trust").

### **Trading Considerations**

The Sponsor does not maintain a secondary market in SPDRs. SPDRs are listed for trading on the Exchange. The market symbol for SPDRs is SPY. Trading in SPDRs on the Exchange may be halted due to market conditions or, in light of Exchange rules and procedures, for reasons that, in the view of the Exchange, make trading in SPDRs inadvisable. In addition, trading in SPDRs on the Exchange is subject to trading halts caused by extraordinary market volatility pursuant to Exchange "circuit breaker" rules that require trading in securities on the Exchange to be halted for a specified time period based on a specified market decline. There can be no assurance that the requirements of the Exchange necessary to maintain the listing of SPDRs will continue to be met or will remain unchanged. The Trust will be terminated in the event SPDRs are delisted from the Exchange. (For a description of the conditions to listing of SPDRs and the circumstances under which the Exchange would consider the suspension of trading in or the delisting of SPDRs, see "Exchange Listing.") Further, the Trust may be terminated, among other reasons, in the event that the License Agreement is terminated or the net asset value of the Trust falls below a specified level (see "Administration of the Trust—Termination").

### **Market Risks**

SPDRs are subject to the risks of an investment in a broadly based portfolio of common stocks, including the risk that the general level of stock prices may decline, thereby adversely affecting the value of such investment. SPDRs are also subject to risks other than those associated with an investment in a broadly based portfolio of common stocks in that the selection of the stocks included in the Trust's portfolio, the

expenses associated with the Trust or other factors distinguishing an ownership interest in a trust from the direct ownership of a portfolio of securities may affect trading in SPDRs as compared with trading in a broadly based portfolio of common stocks. SPDRs are further subject to the risk that extraordinary events may cause any of the parties providing services to the Trust, such as the Trustee, the Sponsor, the Distributor, the Depository or NSCC, to be closed or otherwise unable to perform such party's obligations as set forth herein and in the agreements between and among such parties. According to the terms of the Trust Agreement, if any of the above named entities fails or is otherwise unable to perform adequately its duties, a successor entity may be named or appointed to assume all duties and obligations of its predecessor. If, however, no suitable successor is available or willing to undertake all such duties and obligations, under the Trust Agreement the Trust will then be terminated (see "Administration of the Trust—Termination").

The Trustee will deliver a portfolio of Securities for each Creation Unit size aggregation of SPDRs delivered for redemption, substantially identical in weighting and composition to the securities portion of a Portfolio Deposit as in effect on the date request for redemption is deemed received by the Trustee (see "Redemption of SPDRs"). If a redemption is processed through the SPDR Clearing Process, to the extent that the Securities to be delivered on settlement date are not delivered, they will be covered by NSCC's guarantee of the completion of such delivery. Any Securities not received on settlement date will be marked-to-market until delivery is completed. The Trust, to the extent it has not already done so, remains obligated to deliver such Securities to NSCC, and the market risk of any increase in the value of such Securities until delivery is made by the Trust to NSCC could adversely affect the net asset value of the Trust. Investors should note that the Securities to be delivered to a redeemer submitting a redemption request outside of the SPDR Clearing Process that are not delivered to such redeemer are not covered by NSCC's guarantee of completion of such delivery.

Investors should also note that the size of the Trust in terms of total assets held may change substantially over time and from time to time as SPDRs in Creation Unit size aggregations are created and redeemed. Such fluctuations in Trust size should not adversely impact the net asset value at any time, because the amount of the Cash Component or the Cash Redemption Payment upon creations or redemptions, respectively, of SPDRs in Creation Unit size aggregations is determined each day to equate the value of the Portfolio Deposit to the net asset value of the Trust, on a per Creation Unit basis, at the close of business on the day such request is deemed received by the Trustee (see "The Portfolio—Adjustments to the Portfolio Deposit").

Investors in the Trust should also be aware that there are tax consequences associated with the ownership of SPDRs resulting from the distribution of Trust dividends and sales of SPDRs as well as the sales of underlying Securities held by the

Trust in connection with redemptions under certain circumstances (see “Tax Status of the Trust—Tax Consequences to Beneficial Owners”).

#### **Year 2000 Problem**

Many computer systems were designed in such a way that they may be unable to distinguish between the year 2000 and the year 1900 and therefore may not properly process and calculate date-related information and data (commonly known as the “Year 2000 Problem”). As with all investment and financial companies, the Year 2000 Problem may have an adverse impact upon the handling of securities trades, pricing and account services and other activities conducted by or for the Trust. The Sponsor and the Trustee are taking steps to address the Year 2000 Problem with respect to the computer systems they use and to obtain reasonable assurances that similar steps are being taken by the Trust’s other service providers. At this time, however, there can be no assurance that these steps will be sufficient to avoid any adverse impact to the Trust. The Year 2000 Problem is expected to have an impact on all corporations, including those whose stocks are contained in the Trust’s Portfolio. The Sponsor cannot predict what impact, if any, the Year 2000 Problem will have on the companies with stocks in the Trust.

## THE TRUST

The Trust is a unit investment trust created under the laws of the State of New York pursuant to the Trust Agreement.\* The Securities held by the Trust consist of a portfolio of common stocks or, in the case of securities not yet delivered in connection with purchases made by the Trust or Portfolio Deposits, confirmations of contracts to purchase such securities (collectively, the "Portfolio").

### Creation of Creation Units

Portfolio Deposits may be deposited with the Trustee through the clearing processes of NSCC, following placement with the Distributor of orders to create SPDRs. The Distributor shall reject any order that is not submitted in proper form. Investors may deposit Portfolio Deposits through the SPDR Clearing Process or directly with the Trustee outside the SPDR Clearing Process. The Transaction Fee will be charged at the time of creation of a Creation Unit Size aggregation of SPDRs, and an additional amount not to exceed three (3) times the Transaction Fee applicable for one Creation Unit will be charged to a creator creating outside the SPDR Clearing Process depositing directly with the Trustee through DTC, in part due to the increased expense associated with settlement outside the SPDR Clearing Process. See "Prospectus Summary—Transaction Fee" for a detailed description of the amount of the Transaction Fee and the additional amounts and reductions, limitations and waivers applicable thereto, if any.

The Trustee, at the direction of the Sponsor in its sole discretion, from time to time and for such periods as may be determined by the Sponsor in its sole discretion, will increase\*\* or reduce the amount and/or waive the imposition altogether of the Transaction Fee (and/or the additional amounts charged in connection with creations and/or redemptions outside the SPDR Clearing Process) for certain lot-size creations and/or redemptions of SPDRs, whether applied solely to creations and/or redemptions of SPDRs made through the SPDR Clearing Process (see "Procedures for Creation of Creation Units"), solely to creations and/or redemptions made outside the SPDR Clearing Process, or to both methods of creation and/or redemption. The Sponsor also reserves the right, from time to time, to vary the lot-size of the creations and/or redemptions of SPDRs subject to such an increase and/or entitled to such a reduction or waiver of the Transaction Fee and the additional amounts charged in connection with creations and/or redemptions outside the SPDR Clearing Process. The existence of such increase, reduction or waiver of the Transaction Fee (as well as any additional amounts, if applicable) and the lot-size of Creation Units affected shall be disclosed in the current SPDR Prospectus (see "Prospectus Summary—Transaction Fee"). As

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\* Reference is hereby made to said Trust Agreement, and any statements contained herein are qualified in their entirety by the provisions of said Trust Agreement.

\*\* Such increase is subject to the 10 Basis Point Limit discussed above under "Prospectus Summary—Transaction Fee".



of the date hereof, the Sponsor does not contemplate the reduction, variation by lot-size or waiver of Transaction Fees in connection with the creation or redemption of SPDRs or of the additional amounts charged in connection with the creation or redemption of SPDRs outside the SPDR Clearing Process beyond that which is discussed herein under the caption "Prospectus Summary—Transaction Fee".

The shares of common stock of the Index Securities in a Portfolio Deposit on any date of deposit will reflect the composition and relative weightings of the Index Securities on such day. The portfolio of Index Securities that is the basis for a Portfolio Deposit varies as changes are made in the composition and weighting of the Index Securities (see "The Portfolio—Adjustments to the Portfolio Deposit"). The Trustee will make available to NSCC\*\*\* prior to the commencement of trading on each Business Day a list of the names and required number of shares of each of the Index Securities in the current Portfolio Deposit as well as the amount of the Dividend Equivalent Payment for the previous Business Day. Under certain extraordinary circumstances which may make it impossible for the Trustee to provide such information to NSCC on a given Business Day, NSCC shall use the information regarding the identity and weightings of the Index Securities of the Portfolio Deposit on the previous Business Day. The identity of each of the Index Securities required for a Portfolio Deposit, as in effect on September 30, 1998, is set forth in the above Schedule of Investments. The Sponsor makes available (a) on each Business Day, the Dividend Equivalent Payment effective through and including the previous Business Day, per outstanding SPDR, and (b) every 15 seconds throughout the day at the Exchange a number representing, on a per SPDR basis, the sum of the Dividend Equivalent Payment effective through and including the previous Business Day, plus the current value of the securities portion of a Portfolio Deposit as in effect on such day (which value will occasionally include a cash in lieu amount to compensate for the omission of a particular Index Security from such Portfolio Deposit—see "The Portfolio—Adjustments to the Portfolio Deposit"). Such information is calculated based upon the best information available to the Sponsor and may be calculated by other persons designated to do so by the Sponsor. The inability of the Sponsor to provide such information will not in itself result in a halt in the trading of SPDRs on the Exchange. Investors interested in creating SPDRs or purchasing SPDRs in the secondary market should not rely solely on such information in making investment decisions but should also consider other market information and relevant economic and other factors (including, without limitation, information regarding the S&P 500 Index, the Index Securities and financial instruments based on the S&P 500 Index).

\*\*\* As of December 31, 1998, the American Stock Exchange Clearing LLC, a wholly-owned subsidiary of the American Stock Exchange LLC, owned 33⅓% of the issued and outstanding shares of common stock of NSCC. Also as of such date, National Clearing Corporation, a wholly-owned subsidiary of the National Association of Securities Dealers, Inc., the parent company of the Exchange, owned 33⅓% of the issued and outstanding shares of common stock of NSCC.

Upon receipt of a Portfolio Deposit or Deposits, following placement with the Distributor of an order to create SPDRs, the Trustee will deliver SPDRs in Creation Unit size aggregations to the Depository. In turn, the SPDR position will be removed from the Trustee's account at the Depository and will be allocated to the account of the DTC Participant acting on behalf of the depositor creating Creation Unit(s) (see "The Trust—Procedures for Creation of Creation Units" and "The Trust—Book-Entry-Only System"). Each SPDR represents a fractional undivided interest in the Trust in an amount equal to one (1) divided by the total number of SPDRs outstanding. The Trustee may reject a request to create Creation Units made by any depositor or group of depositors if such depositor(s), upon the acceptance by the Trustee of such request and the issuance to such depositor(s) of SPDRs, would own eighty percent (80%) or more of the outstanding SPDRs (see "Tax Status of the Trust"). The Trustee also may reject any Portfolio Deposit or any component thereof under certain other circumstances (see "The Trust—Procedures for Creation of Creation Units").

Additional SPDRs in Creation Unit size aggregations will be created upon receipt of the appropriate Portfolio Deposits from creators. As additional SPDRs in Creation Unit size aggregations are created, the aggregate value of the Portfolio will be increased and the fractional undivided interest in the Trust represented by each SPDR will be decreased. As discussed above, under certain circumstances (1) a portion of the securities portion of a Portfolio Deposit may consist of contracts to purchase certain Index Securities or (2) a portion of the Cash Component may consist of cash in an amount to enable the Trustee to purchase such Index Securities. In the event there is a failure to deliver the Index Securities which are the subject of such contracts to purchase, the Trustee will be instructed pursuant to the Agreement to acquire such Index Securities in an expeditious manner. To the extent the price of any such Index Security increases or decreases between the time of creation and the time any such Index Security is purchased and delivered, SPDRs will represent fewer or more shares of such Index Security and more or fewer of the other Index Securities in the Trust. Hence, price fluctuations during the period from the time the cash is received by the Trustee to the time the requisite Index Securities are purchased and delivered will affect the value of all SPDRs.

The identity and number of shares of the Index Securities required for a Portfolio Deposit are determined in the manner described herein. Due to changes in the composition and weighting of the Index Securities, the composition and weighting of the Securities and the prescribed Portfolio Deposit will also change from time to time (see "The Portfolio—Adjustments to the Portfolio" and "The Portfolio—Adjustments to the Portfolio Deposit"). The identity and weightings of the Index Securities to be delivered as part of a Portfolio Deposit are determined daily and reflect the relative weighting of the current S&P 500 Index and, together with the Cash Component, have a value equal to the net asset value of the Trust on a per Creation

Unit basis at the close of business on the day of request for creation. The composition of the Portfolio is also adjusted from time to time to conform to the changes to the S&P 500 Index as described herein and as set forth in the Trust Agreement. As the weightings and identities of the Index Securities change, substantially identical changes to the composition of the required Portfolio Deposit are made contemporaneously. Corresponding adjustments to the composition or weighting of the Portfolio, however, are not necessarily made contemporaneously with adjustments to the required Portfolio Deposit, but are made in accordance with the specifications set forth herein and in the Trust Agreement (see "The Portfolio—Adjustments to the Portfolio"). Although the composition of the securities portion of a Portfolio Deposit changes from time to time, the interests of Beneficial Owners will not be adversely affected because the composition of such securities and the aggregate value thereof, together with the Cash Component, will be calculated based upon the proportionate net asset value of the Trust (see "The Portfolio—Adjustments to the Portfolio").

#### **Procedures for Creation of Creation Units**

To be eligible to place orders with the Distributor to create SPDRs in Creation Unit size aggregations, an entity or person must be (1) a Participating Party, with respect to creations through the SPDR Clearing Process or (2) a DTC Participant with respect to creations/redemptions outside the SPDR Clearing Process. All SPDRs, however created, will be entered on the records of the Depository in the name of Cede & Co. for the account of a DTC Participant (see "The Trust—Book Entry Only System").

All orders to create SPDRs must be placed in multiples of 50,000 SPDRs (Creation Unit size). All orders to create SPDRs, whether through the SPDR Clearing Process or outside the SPDR Clearing Process, must be received by the Distributor by no later than the closing time of the regular trading session on the New York Stock Exchange, Inc. ("Closing Time") (ordinarily 4:00 p.m. New York time) in each case on the date such order is placed in order for creation of SPDRs to be effected based on the net asset value of the Trust as determined on such date. The date on which a creation order (or order to redeem as discussed below) is placed is herein referred to as the "Transmittal Date". Orders must be transmitted by telephone or other transmission method acceptable to the Distributor and Trustee, pursuant to procedures set forth in the Participant Agreement, as described below (see "Placement of Creation Orders Using SPDR Clearing Process" and "Placement of Creation Orders Outside SPDR Clearing Process"). Severe economic or market disruptions or changes, or telephone or other communication failure, may impede the ability to reach the Distributor, the Trustee, a Participating Party or a DTC Participant.

Orders to create Creation Unit sized aggregations of SPDRs shall be placed with a Participating Party or DTC Participant, as applicable, in the form required by such Participating Party or DTC Participant. Investors should be aware that their particular

broker may not have executed a Participant Agreement, and that, therefore, orders to create Creation Unit sized aggregations of SPDRs may have to be placed by the investor's broker through a Participating Party or a DTC Participant who has executed a Participant Agreement. At any given time there may be only a limited number of broker-dealers that have executed a Participant Agreement. Those placing orders to create SPDRs through the SPDR Clearing Process should afford sufficient time to permit proper submission of the order to the Distributor prior to the Closing Time on the Transmittal Date.

Orders for creation that are effected outside the SPDR Clearing Process are likely to require transmittal by the DTC Participant earlier on the Transmittal Date than orders effected using the SPDR Clearing Process. Those persons placing orders outside the SPDR Clearing Process should ascertain the deadlines applicable to DTC and the Federal Reserve Bank wire transfer system by contacting the operations department of the broker or depository institution effectuating such transfer of securities and Cash Component. The DTC Participant notified of an order to create SPDRs outside the SPDR Clearing Process shall be required to effect a transfer of (1) the requisite Index Securities through DTC by 11:00 a.m. on the next Business Day immediately following the Transmittal Date in such a way as to replicate the Portfolio Deposit established on the Transmittal Date by the Trustee in calculating the net asset value of the Trust and (2) the Cash Component through the Federal Reserve Bank wire transfer system so as to be received by the Trustee by 2:00 p.m. on the next Business Day immediately following the Transmittal Date. If the Trustee does **not** receive both the Index Securities by 11:00 a.m. and the Cash Component by 2:00 p.m. on the next Business Day immediately following the Transmittal Date, such order shall be cancelled. Upon written notice to the Distributor, such cancelled order may be resubmitted the following Business Day using a Portfolio Deposit as newly constituted to reflect the current net asset value of the Trust.

All questions as to the number of shares of each of the Index Securities, the amount of the Cash Component and the validity, form, eligibility (including time of receipt) and acceptance for deposit of any Index Securities to be delivered shall be determined by the Trustee, whose determination shall be final and binding. The Trustee reserves the absolute right to reject a creation order transmitted to it by the Distributor in respect of any Portfolio Deposit or any component thereof if (a) the depositor or group of depositors, upon obtaining the SPDRs ordered, would own 80% or more of the current outstanding SPDRs, (b) the Portfolio Deposit is not in proper form; (c) acceptance of the Portfolio Deposit would have certain adverse tax consequences (see "Tax Status of the Trust"); (d) the acceptance of the Portfolio Deposit would, in the opinion of counsel, be unlawful; (e) the acceptance of the Portfolio Deposit would otherwise, in the discretion of the Trustee, have an adverse effect on the Trust or the rights of Beneficial Owners; or (f) in the event that circumstances outside the control of the Trustee make it for all practical purposes

impossible to process creations of SPDRs. The Trustee and the Sponsor are under no duty to give notification of any defects or irregularities in the delivery of Portfolio Deposits or any component thereof nor shall either of them incur any liability for the failure to give any such notification.

A list of the Participating Parties or DTC Participants that have executed a Participant Agreement (as hereinafter defined) is available at the office of the Trustee at 1776 Heritage Drive, North Quincy, Massachusetts 02171 and the office of the Distributor at 370 17th Street, Suite 3100, Denver, CO 80202 during normal business hours.

#### **Placement of Creation Orders Using SPDR Clearing Process**

Portfolio Deposits created through the SPDR Clearing Process must be delivered through a Participating Party (see “Prospectus Summary—Portfolio Deposits”) that has executed a Participant Agreement with the Distributor and with the Trustee (as the same may be from time to time amended in accordance with its terms, the “Participant Agreement”). The Participant Agreement authorizes the Trustee to transmit to NSCC on behalf of the Participating Party such trade instructions as are necessary to effect the Participating Party’s creation order. Pursuant to such trade instructions from the Trustee to NSCC, the Participating Party agrees to transfer the requisite Index Securities (or contracts to purchase such Index Securities that are expected to be delivered through the SPDR Clearing Process in a “regular way” manner by the third (3rd) NSCC Business Day) and the Cash Component to the Trustee, together with such additional information as may be required by the Trustee. An order to create SPDRs through the SPDR Clearing Process is deemed received by the Distributor on the Transmittal Date if (i) such order is received by the Distributor not later than the Closing Time on such Transmittal Date and (ii) all other procedures set forth in the Participant Agreement are properly followed.

#### **Placement of Creation Orders Outside SPDR Clearing Process**

Portfolio Deposits created outside the SPDR Clearing Process must be delivered through a DTC Participant that has executed a Participant Agreement with the Distributor and with the Trustee. A DTC Participant who wishes to place an order creating SPDRs to be effected outside the SPDR Clearing Process need not be a Participating Party, but such orders must state that the DTC Participant is not using the SPDR Clearing Process and that the creation of SPDRs will instead be effected through a transfer of securities and cash. The Portfolio Deposit transfer must be ordered by the DTC Participant in a timely fashion so as to ensure the delivery of the requisite number of Index Securities through DTC to the account of the Trustee by no later than 11:00 a.m. of the next Business Day immediately following the Transmittal Date. All questions as to the number of Index Securities to be delivered, and the validity, form and eligibility (including time of receipt) for the deposit of any tendered securities, will be determined by the Trustee, whose determination shall be final and

binding. The cash equal to the Cash Component must be transferred directly to the Trustee through the Federal Reserve Bank wire transfer system in a timely manner so as to be received by the Trustee no later than 2:00 p.m. on the next Business Day immediately following the Transmittal Date. An order to create SPDRs outside the SPDR Clearing Process is deemed received by the Distributor on the Transmittal Date if (i) such order is received by the Distributor not later than the Closing Time on such Transmittal Date and (ii) all other procedures set forth in the Participant Agreement are properly followed. However, if the Trustee does not receive both the requisite Index Securities and the Cash Component in a timely fashion on the next Business Day immediately following the Transmittal Date, such order will be cancelled. Upon written notice to the Distributor, such cancelled order may be resubmitted the following Business Day using a Portfolio Deposit as newly constituted to reflect the current net asset value of the Trust. The delivery of SPDRs so created will occur no later than the third (3rd) Business Day following the day on which the creation order is deemed received by the Distributor. Under the current schedule, the total fee charged in connection with the creation of one Creation Unit outside the SPDR Clearing Process would not exceed \$12,000 (see "Prospectus Summary—Transaction Fee").

SPDRs may be created in advance of the receipt by the Trustee of all or a portion of the Portfolio Deposit relating to such SPDRs as described below. In these circumstances, the initial deposit will have a value greater than the net asset value of the SPDRs on the date the order is placed in proper form since in addition to available Deposit Securities, cash collateral must be deposited with the Trustee in an amount equal to the sum of (i) the Cash Component, plus (ii) 115% of the market value of the undelivered Deposit Securities (the "Additional Cash Deposit"). The Trustee will hold such Additional Cash Deposit as collateral in an account separate and apart from the Trust. The order shall be deemed to be received on the Business Day on which the order is placed provided that the order is placed in proper form prior to 4:00 p.m., New York time, on such date and federal funds in the appropriate amount are deposited with the Trustee by 11:00 a.m., New York time, the next following Business Day. If the order is not placed in proper form by 4:00 p.m. or federal funds in the appropriate amount are not received by 11:00 a.m. the next following Business Day, then the order may be deemed to be rejected and the investor shall be liable to the Trust for losses, if any, resulting therefrom. An additional amount of cash shall be required to be deposited with the Trustee, pending delivery of the missing Deposit Securities to the extent necessary to maintain the Additional Cash Deposit with the Trustee in an amount at least equal to 115% of the daily marked to market value of the missing Deposit Securities. To the extent that missing Deposit Securities are not received by 1:00 p.m., New York time, on the third Business Day following the day on which the purchase order is deemed received or in the event a mark to market payment is not made within one Business Day following notification by the Distributor that such a payment is required, the Trustee may use the Additional Cash Deposit to purchase the missing Deposit Securities. Authorized Participants will be liable to the Trust for the costs incurred by the Trust in connection with any such

purchases. These costs will be deemed to include the amount by which the actual purchase price of the Deposit Securities exceeds the market value of such Deposit Securities on the day the purchase order was deemed received by the Distributor plus the brokerage and related transaction costs associated with such purchases. The Trustee will return any unused portion of the Additional Cash Deposit once all of the missing Deposit Securities have been properly received or purchased by the Trustee and deposited into the Trust. In addition, a transaction fee of \$4,000 will be charged in all cases. The delivery of Creation Units of SPDRs so created will occur no later than the third Business Day following the day on which the purchase order is deemed received. The Participant Agreement for any Participating Party intending to follow such procedures will contain terms and conditions permitting the Trust to use such collateral to buy the missing portion(s) of the Portfolio Deposit at any time and will subject such Participating Party to liability for any shortfall between the cost to the Trust of purchasing such securities and the value of such collateral. The Trust will have no liability for any such shortfall.

#### **Book-Entry-Only System**

The Depository acts as securities depository for SPDRs. SPDRs are represented by a single global security (the "Global Security"), which is registered in the name of Cede & Co., as nominee for the Depository and deposited with, or on behalf of, the Depository. Certificates will not be issued for SPDRs.

The Depository has advised the Sponsor and the Trustee as follows: The Depository is a limited-purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. The Depository was created to hold securities of its participants (the "DTC Participants") and to facilitate the clearance and settlement of securities transactions among the DTC Participants in such securities through electronic book-entry changes in accounts of the DTC Participants, thereby eliminating the need for physical movement of securities certificates. DTC Participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations, some of whom (and/or their representatives) own the Depository.\* Access to the Depository system is also

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\* As of December 31, 1998, the National Association of Securities Dealers, Inc., the parent company of the Exchange, owned 4.65211% of the issued and outstanding shares of the common stock of the Depository, the Exchange owned 4.65211% of the issued and outstanding shares of common stock of the Depository and a wholly-owned subsidiary of the Exchange, American Stock Exchange Clearing LLC, owned 0.00188% of the issued and outstanding shares of common stock of the Depository. Also as of such date, the Trustee owned 4.8482% of the issued and outstanding shares of the common stock of the Depository.

available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a DTC Participant, either directly or indirectly (the "Indirect Participants"). The Depository agrees with and represents to its participants that it will administer its book-entry system in accordance with its rules and by-laws and requirements of law.

Upon the settlement date of any creation, transfer or redemption of SPDRs, the Depository will credit or debit, on its book-entry registration and transfer system, the amount of SPDRs so created, transferred or redeemed to the accounts of the appropriate DTC Participants. The accounts to be credited and charged shall be designated by the Trustee to NSCC, in the case of a creation or redemption through the SPDR Clearing Process, or by the Trustee and the DTC Participant, in the case of a creation or redemption transacted outside of the SPDR Clearing Process (see "The Trust—Procedures for Creation of Creation Units" and "Redemption of SPDRs"). Beneficial ownership of SPDRs is limited to DTC Participants, Indirect Participants and persons holding interests through DTC Participants and Indirect Participants. Ownership of beneficial interests in SPDRs (owners of such beneficial interests are referred to herein as "Beneficial Owners") will be shown on, and the transfer of ownership will be effected only through, records maintained by the Depository (with respect to DTC Participants) and on the records of DTC Participants (with respect to Indirect Participants and Beneficial Owners that are not DTC Participants). Beneficial Owners are expected to receive from or through the DTC Participant a written confirmation relating to their purchase of SPDRs. The laws of some jurisdictions may require that certain purchasers of securities take physical delivery of such securities in definitive form. Such laws may impair the ability of certain investors to acquire beneficial interests in SPDRs.

So long as Cede & Co., as nominee of the Depository, is the registered owner of SPDRs, references herein to the registered or record owners of SPDRs shall mean Cede & Co. and shall not mean the Beneficial Owners of SPDRs. Beneficial Owners of SPDRs will not be entitled to have SPDRs registered in their names, will not receive or be entitled to receive physical delivery of certificates in definitive form and will not be considered the record or registered holder thereof under the Trust Agreement. Accordingly, each Beneficial Owner must rely on the procedures of the Depository, the DTC Participant and any indirect Participant through which such Beneficial Owner holds its interests, to exercise any rights of a holder of SPDRs under the Trust Agreement. The Trustee and the Sponsor understand that under existing industry practice, in the event the Trustee requests any action of SPDR holders, or a Beneficial Owner desires to take any action that the Depository, as the record owner of all outstanding SPDRs, is entitled to take, the Depository would authorize the DTC Participants to take such action and that the DTC Participants would authorize the indirect Participants and Beneficial Owners acting through such DTC Participants to take such action or would otherwise act upon the instructions of Beneficial Owners owning through them.



As described above, the Trustee recognizes the Depository or its nominee as the owner of all SPDRs for all purposes except as expressly set forth in the Trust Agreement. Conveyance of all notices, statements and other communications to Beneficial Owners is effected as follows. Pursuant to the agreement between the Trustee and the Depository (as the same may be from time to time amended in accordance with its terms, the "Depository Agreement"), the Depository is required to make available to the Trustee upon request and for a fee to be charged to the Trust a listing of the SPDR holdings of each DTC Participant. The Trustee shall inquire of each such DTC Participant as to the number of Beneficial Owners holding SPDRs, directly or indirectly, through such DTC Participant. The Trustee shall provide each such DTC Participant with copies of such notice, statement or other communication, in such form, number and at such place as such DTC Participant may reasonably request, in order that such notice, statement or communication may be transmitted by such DTC Participant, directly or indirectly, to such Beneficial Owners. In addition, the Trust shall pay to each such DTC Participant a fair and reasonable amount as reimbursement for the expenses attendant to such transmittal, all subject to applicable statutory and regulatory requirements.

SPDR distributions shall be made to the Depository or its nominee, Cede & Co., as the registered owner of all SPDRs. The Trustee and the Sponsor expect that the Depository or its nominee, upon receipt of any payment of distributions in respect of SPDRs, shall credit immediately DTC Participants' accounts with payments in amounts proportionate to their respective beneficial interests in SPDRs as shown on the records of the Depository or its nominee. The Trustee and the Sponsor also expect that payments by DTC Participants to indirect Participants and Beneficial Owners of SPDRs held through such DTC Participants will be governed by standing instructions and customary practices, as is now the case with securities held for the accounts of customers in bearer form or registered in a "street name," and will be the responsibility of such DTC Participants. Neither the Trustee nor the Sponsor has or will have any responsibility or liability for any aspects of the records relating to or notices to Beneficial Owners, or payments made on account of beneficial ownership interests in SPDRs, or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests or for any other aspect of the relationship between the Depository and the DTC Participants or the relationship between such DTC Participants and the indirect Participants and Beneficial Owners owning through such DTC Participants.

Beneficial Owners may elect to have their distributions reinvested in additional SPDRs (see "Dividend Reinvestment Service").

The Depository may determine to discontinue providing its service with respect to SPDRs at any time by giving notice to the Trustee and the Sponsor and discharging its responsibilities with respect thereto under applicable law. Under such

circumstances, the Trustee and the Sponsor shall take action either to find a replacement for the Depository to perform its functions at a comparable cost or, if such a replacement is unavailable, to terminate the Trust (see "Termination of the Trust").

### **THE PORTFOLIO**

Because the objective of the Trust is to provide investment results that correspond substantially to the price and yield performance of the S&P 500 Index, the Portfolio will at any time consist of as many of the Index Securities as is practicable. It is anticipated that cash or cash items (other than dividends held for distribution) normally would not be a substantial part of the Trust's net assets. Although the Trust may at any time fail to own certain of the Index Securities, the Trust will be substantially invested in Index Securities and the Sponsor believes that such investment should result in a close correspondence between the investment performance of the S&P 500 Index and that derived from ownership of SPDRs.

#### **Adjustments to the Portfolio**

The S&P 500 Index is a capitalization-weighted index of 500 securities calculated under the auspices of the S&P Committee of Standard and Poor's. At any moment in time, the value of the Index equals the aggregate market value of the total shares outstanding in each of the component 500 Index Securities, evaluated at their respective last sale prices on the NYSE, AMEX or NASDAQ, divided by a scaling factor (the "divisor") which yields a resulting index value in the reported magnitude.

Periodically (typically, several times per quarter), Standard & Poor's may determine that total shares outstanding have changed in one or more component Index Securities due to secondary offerings, repurchases, conversions or other corporate actions. Additionally, the S&P Committee may periodically (ordinarily, several times per quarter) replace one or more component securities in the Index due to mergers, acquisitions, bankruptcies, or other market conditions, or if the issuers of such component securities fail to meet the criteria for inclusion in the Index. In 1998, there were 48 company changes to the S&P 500 Index. Ordinarily, whenever there is a change in shares outstanding or a change in a component security included in the S&P 500 Index, Standard & Poor's adjusts the divisor to assure that there is no discontinuity in the value of the S&P 500 Index which might otherwise be caused by any such change.

Because the investment objective of the Trust is to provide investment results, before expenses, that generally correspond to the price and yield performance of the S&P 500 Index, such share, name, and divisor changes to the S&P 500 Index create the need for the Trust to make corresponding portfolio adjustments as described below.

The Trustee adjusts the composition of the Portfolio from time to time to conform to changes in the composition and/or weighting structure of the Index Securities. The Trustee aggregates certain of these adjustments and makes conforming changes to the Trust's portfolio at least monthly; however, adjustments are made more

frequently in the case of changes to the S&P 500 Index that are significant. Specifically, the Trustee is required to adjust the composition of the Portfolio at any time that there is a change in the identity of any Index Security (*i.e.*, a substitution of one security in replacement of another), which adjustment is to be made within three (3) Business Days before or after the day on which the change in the identity of such Index Security is scheduled to take effect at the close of the market. Although the investment objective of the Trust is to provide investment results which resemble the performance of the S&P 500 Index, it is not always efficient to replicate identically the share composition of the S&P 500 Index if the transaction costs incurred by the Trust in so adjusting the Portfolio would exceed the expected misweighting that would ensue by failing to replicate identically minor and insignificant share changes to the S&P 500 Index. Accordingly, to further the investment objective of the Trust, minor misweightings are generally permitted within the guidelines set forth below. The Trustee is required to adjust the composition of the Portfolio at any time that the weighting of any Security varies in excess of one hundred and fifty percent (150%) of a specified percentage, which percentage varies from 8/100 of 1% to 2/100 of 1%, depending on the net asset value of the Trust (in each case, the "Misweighting Amount"), from the weighting of such Security in the S&P 500 Index (a "Misweighting").

The Trustee shall examine each Security in the Portfolio on each Business Day, comparing the weighting of each such Security in the Portfolio to the weighting of the corresponding Index Security in the S&P 500 Index, based on prices at the close of the market on the preceding Business Day (a "Weighting Analysis"). In the event that there is a Misweighting in any Security in excess of one hundred and fifty percent (150%) of the applicable Misweighting Amount, the Trustee shall calculate an adjustment to the Portfolio in order to bring the Misweighting of such Security within the Misweighting Amount, based on prices at the close of the market on the day on which such Misweighting occurs. Also, on a monthly basis, the Trustee shall perform a Weighting Analysis for each Security in the Portfolio, and in any case where there exists a Misweighting exceeding one hundred percent (100%) of the applicable Misweighting Amount, the Trustee shall calculate an adjustment to the Portfolio in order to bring the Misweighting of such Security within the applicable Misweighting Amount, based on prices at the close of the market on the day on which such Misweighting occurs. In the case of any adjustment to the Portfolio due to a Misweighting as described herein, the purchase or sale of securities necessitated by such adjustment shall be made within three (3) Business Days of the day on which such Misweighting is determined. In addition to the foregoing adjustments, the Trustee reserves the right to make additional adjustments periodically to Securities that may be misweighted by an amount within the applicable Misweighting Amount in order to reduce the overall Misweighting of the Portfolio.

The foregoing guidelines with respect to Misweightings shall also apply to any Index Security that (1) is likely to be unavailable for delivery or available in

insufficient quantity for delivery or (2) cannot be delivered to the Trustee due to restrictions prohibiting a creator from engaging in a transaction involving such Index Security. Upon receipt of an order for a Creation Unit that will involve such an Index Security, the Trustee shall determine whether the substitution of cash for such Index Security will cause a Misweighting in the Trust's Portfolio with respect to such Index Security. If a Misweighting results, the Trustee shall purchase the required number of shares of such Index Security on the opening of the market on the following Business Day. If a Misweighting does not result and the Trustee would not hold cash in excess of the permitted amounts described herein, the Trustee may hold such cash or, if such an excess would result, make the required adjustments to the Portfolio in accordance with the procedures described herein.

Pursuant to these guidelines the Trustee shall calculate the required adjustments and shall purchase and sell the appropriate securities. As a result of the purchase and sale of securities in accordance with these requirements, or the creation of Creation Units, the Trust may hold some amount of residual cash (other than cash held temporarily due to timing differences between the sale and purchase of securities or cash delivered in lieu of Index Securities or undistributed income or undistributed capital gains) as a result of such transactions, which amount shall not exceed for more than two (2) consecutive Business Days 5/10th of 1 percent of the aggregate value of the Securities. In the event that the Trustee has made all required adjustments and is left with cash in excess of 5/10th of 1 percent of the aggregate value of the Securities, the Trustee shall use such cash to purchase additional Index Securities that are underweighted in the Portfolio as compared to their relative weightings in the S&P 500 Index, although the Misweighting of such Index Securities may not be in excess of the applicable Misweighting Amount.

All adjustments to the Portfolio held by the Trustee shall be made by the Trustee pursuant to the foregoing specifications and as set forth in the Trust Agreement and shall be non-discretionary. All portfolio adjustments will be made as described herein unless such adjustments would cause the Trust to lose its status as a "regulated investment company" under Subchapter M of the Internal Revenue Code. Additionally, the Trustee is required to adjust the composition of the Portfolio at any time if it is necessary to insure the continued qualification of the Trust as a regulated investment company (see "Tax Status of the Trust"). The adjustments provided herein are intended to conform the composition and weightings of the Portfolio, to the extent practicable, to the composition and weightings of the Index Securities. Such adjustments are based upon the S&P 500 Index as it is currently determined by Standard & Poor's. To the extent that the method of determining the S&P 500 Index is changed by Standard & Poor's in a manner that would affect the adjustments provided for herein, the Trustee and the Sponsor shall have the right to amend the Trust Agreement, without the consent of the Depository or Beneficial Owners, to conform the adjustments provided herein and in the Trust Agreement to such changes so that the objective of tracking the S&P 500 Index is maintained.

In making the adjustments described herein, the Trustee shall rely on industry sources for information as to the composition and weightings of the Index Securities. If the Trustee becomes incapable of obtaining or processing such information or NSCC is unable to receive such information from the Trustee on any Business Day, then the Trustee shall use the composition and weightings of the Index Securities for the most recently effective Portfolio Deposit for the purposes of all adjustments and determinations described herein (including, without limitation, determination of the securities portion of the Portfolio Deposit) until the earlier of (a) such time as current information with respect to the Index Securities is available or (b) three (3) consecutive Business Days have elapsed. If such current information is not available and three (3) consecutive Business Days have elapsed, the composition and weightings of the Securities (as opposed to the Index Securities) shall be used for the purposes of all adjustments and determinations herein (including, without limitation, determination of the securities portion of the Portfolio Deposit) until current information with respect to the Index Securities is available.

At such time as the Trustee gives written notice of the termination of the Trust (see "Administration of the Trust—Termination"), from and after the date of such notice the Trustee shall use the composition and weightings of the Securities as of such notice date for the purpose and determination of all redemptions or other required uses of the basket.

From time to time Standard & Poor's may make adjustments to the composition of the S&P 500 Index as a result of a merger or acquisition involving one or more of the Index Securities. In such cases, the Trust, as shareholder of securities of an issuer that is the object of such merger or acquisition activity, may receive various offers from would-be acquirors of the issuer. The Trustee is not permitted to accept any such offers until such time as it has been determined that the securities of the issuer will be removed from the S&P 500 Index. Since securities of an issuer are often removed from the S&P 500 Index only after the consummation of a merger or acquisition of such issuer, in selling the securities of such issuer the Trust may receive, to the extent that market prices do not provide a more attractive alternative, whatever consideration is being offered to the shareholders of such issuer that have not tendered their shares prior to such time. Any cash received in such transactions will be reinvested in Index Securities in accordance with the criteria set forth above. Any securities received as a part of the consideration that are not Index Securities will be sold as soon as practicable and the cash proceeds of such sale will be reinvested in accordance with the criteria set forth above.

Purchases and sales of Securities resulting from the adjustments described above will be made in the share amounts dictated by the foregoing specifications, whether round lot or odd lot. Certain Index Securities, however, may at times not be available in the quantities that the foregoing calculations require. For this and other reasons,

precise duplication of the proportionate relationship between the Portfolio and the Index Securities may not ever be possible but nevertheless will continue to be the objective in connection with all acquisitions and dispositions of Securities.

The Trust is a unit investment trust registered under the 1940 Act, and is not a managed fund. Traditional methods of investment management for a managed fund typically involve frequent changes to a portfolio of securities on the basis of economic, financial and market analyses. The Portfolio held by the Trust, however, is not managed. Instead, the only purchases and sales that are made with respect to the Portfolio will be those necessary to create, to the extent feasible, a portfolio that is designed to replicate the S&P 500 Index to the extent practicable, taking into consideration the adjustments referred to above. Since no attempt is made to “manage” the Trust in the traditional sense, the adverse financial condition of an issuer will not be the basis for the sale of its securities from the Portfolio unless the issuer is removed from the S&P 500 Index.

The Trust will be liquidated on the fixed Mandatory Termination Date unless terminated earlier under certain circumstances (see “Administration of the Trust—Termination”). In addition, Beneficial Owners of SPDRs in Creation Unit size aggregations have the right to redeem in kind (see “Redemption of SPDRs”).

#### **Adjustments to the Portfolio Deposit**

On each Business Day (each such day an “Adjustment Day”), the number of shares and/or identity of each of the Index Securities in a Portfolio Deposit is adjusted in accordance with the following procedure. At the close of the market on each Adjustment Day, the Trustee calculates the net asset value of the Trust (see “Valuation”). The net asset value is divided by the number of outstanding SPDRs multiplied by 50,000 SPDRs in one Creation Unit aggregation resulting in a net asset value per Creation Unit (the “NAV Amount”). The Trustee then calculates the number of shares (without rounding) of each of the component stocks of the S&P 500 Index in a Portfolio Deposit for the following Business Day (“Request Day”), such that (1) the market value at the close of the market on Adjustment Day of the securities to be included in the Portfolio Deposit on Request Day, together with the Dividend Equivalent Payment effective for requests to create or redeem on Adjustment Day, equals the NAV Amount and (2) the identity and weighting of each of the securities in a Portfolio Deposit mirrors proportionately the identity and weightings of the securities in the S&P 500 Index, each as in effect on Request Day. For each security, the number resulting from such calculation is rounded to the nearest whole share, with a fraction of 0.50 being rounded up. The identities and weightings of the securities so calculated constitute the securities portion of the Portfolio Deposit effective on Request Day and thereafter until the next subsequent Adjustment Day, as well as the Securities to be delivered by the Trustee in the event of request for

redemption of SPDRs in Creation Unit size aggregations on Request Day and thereafter until the following Adjustment Day (see "Redemption of SPDRs"). In addition to the foregoing adjustments, in the event that there shall occur a stock split, stock dividend or reverse split with respect to any Index Security that does not result in an adjustment to the S&P 500 Index divisor, the Portfolio Deposit shall be adjusted to take account of such stock split, stock dividend or reverse split by applying the stock split, stock dividend or reverse stock split multiple (*e.g.*, in the event of a two-for-one stock split of an Index Security, by doubling the number of shares of such Index Security in the prescribed Portfolio Deposit), in each case rounded to the nearest whole share.

On Request Day and on each day that a request for the creation or redemption of SPDRs in Creation Unit size aggregations is deemed received, the Trustee calculates the market value of the securities portion of the Portfolio Deposit as in effect on Request Day as of the close of the market and adds to that amount the Dividend Equivalent Payment effective for requests to create or redeem on Request Day (such market value and Dividend Equivalent Payment are collectively referred to herein as the "Portfolio Deposit Amount"). The Trustee then calculates the NAV Amount, based on the close of the market on Request Day. The difference between the NAV Amount so calculated and the Portfolio Deposit Amount is the "Balancing Amount". The Balancing Amount serves the function of compensating for any differences between the value of the Portfolio Deposit Amount and the NAV Amount at the close of trading on Request Day due to, for example, (1) differences in the market value of the securities in the Portfolio Deposit and the market value of the Securities on Request Day and (2) any variances from the proper composition of the Portfolio Deposit.

Notwithstanding the foregoing, on any Adjustment Day on which (a) no change in the identity and/or share weighting of any Index Security is scheduled to take effect that would cause the S&P 500 Index divisor to be adjusted after the close of the market on such Business Day,\* and (b) no stock split, stock dividend or reverse stock split with respect to any Index Security has been declared to take effect on the corresponding Request Day, the Trustee reserves the right to forego making any adjustment to the Securities portion of the Portfolio Deposit and to use the composition and weightings of the Index Securities for the most recently effective Portfolio Deposit for the Request Day following such Adjustment Day. In addition, the Trustee further reserves the right to calculate the adjustment to the number of shares and/or identity of the Index Securities in a Portfolio Deposit as described above except that such calculation would be employed two (2) Business Days rather than one (1) Business Day prior to Request Day.

\* Standard & Poor's publicly announces changes in the identity and/or weighting of the S&P 500 Index component securities up to five business days in advance of the actual change. The announcements are made after the close of trading on such day.

As previously discussed, the Dividend Equivalent Payment and the Balancing Amount in effect at the close of business on Request Date are collectively referred to as the Cash Component or the Cash Redemption Payment (see “Prospectus Summary—Portfolio Deposits” and “Prospectus Summary—Redemption”). If the Balancing Amount is a positive number (*i.e.*, if the NAV Amount exceeds the Portfolio Deposit Amount) then, with respect to the creation of SPDRs, the Balancing Amount shall increase the Cash Component of the then effective Portfolio Deposit transferred to the Trustee by a creator, and with respect to redemptions of SPDRs in Creation Unit size aggregations, the Balancing Amount shall be added to the cash transferred to a redeemer by the Trustee. If the Balancing Amount is a negative number (*i.e.*, if the NAV Amount is less than the Portfolio Deposit Amount) then, with respect to the creation of SPDRs such amount shall decrease the Cash Component of the then effective Portfolio Deposit to be transferred to the Trustee by the creator or, if such cash portion is less than the Balancing Amount, the difference shall be paid by the Trustee to the creator, and with respect to redemptions of SPDRs in Creation Unit size aggregations, the Balancing Amount shall be deducted from the cash transferred to the redeemer or, if such cash is less than the Balancing Amount, the difference shall be paid by the redeemer to the Trustee.

In the event that the Trustee has included the cash equivalent value of one or more Index Securities in the Portfolio Deposit because the Trustee has determined that such Index Securities are likely to be unavailable or available in insufficient quantity for delivery, the Portfolio Deposit so constituted shall dictate the Index Securities to be delivered in connection with the creation of SPDRs in Creation Unit size aggregations and upon the redemption of SPDRs in Creation Unit size aggregations for all purposes hereunder until such time as the securities portion of the Portfolio Deposit is subsequently adjusted.

In connection with the creation of SPDRs, if an investor is restricted by regulation or otherwise from investing or engaging in a transaction in one or more Index Securities, the Trustee, in its discretion, shall have the right to include the cash equivalent value of such Index Securities in the Portfolio Deposit as part of the Cash Component in lieu of the inclusion of such Index Securities in the securities portion of the Portfolio Deposit for the particular affected investor. The amount of such cash equivalent payment shall be used by the Trustee in accordance with the guidelines regarding allowable Misweightings and permitted amounts of cash (see “The Portfolio—Adjustments to the Portfolio”) which may require the Trustee to purchase the appropriate number of shares of the Index Security that such investor was unable to purchase. In any such case such investor shall pay the Trustee the standard Transaction Fee, plus an additional amount per Creation Unit aggregation not to exceed (3) times the Transaction Fee applicable for one Creation Unit.



### **Selection and Acquisition of Securities**

In prescribing the method described above for selecting the Index Securities that constitute the prescribed Portfolio Deposit from time to time, the Sponsor intends to duplicate, to the extent practicable, the composition and weighting of the Index Securities as of the relevant date.

The yield and price of common stocks deposited in the Trust are dependent on a variety of factors, including money market conditions and general conditions of the corporate equity markets. The Schedule of Investments set forth above contains information as of the date set forth therein with respect to the number of shares of each of the Index Securities in the Portfolio Deposit as of such date. The proportionate relationship among such Securities approximated (although it did not exactly duplicate) the proportionate relationships of the Index Securities as of such date.

Because certain of the Securities from time to time may be sold or their relative percentages changed under certain circumstances as described herein, no assurance can be given that the Trust will retain for any length of time its present size and composition (see "The Portfolio—Adjustments to the Portfolio"). Also, the deposit of additional Portfolio Deposits and the redemption of SPDRs in Creation Unit size aggregations will affect the size and composition of the Trust. Neither the Sponsor nor the Trustee shall be liable in any way for any default, failure or defect in any of the Securities.

### **THE S&P 500 INDEX**

The Sponsor selected the S&P 500 Index as the basis for the selection of the securities held by the Trust because it is well known to investors and, in the opinion of the Sponsor, constitutes a broadly diversified, representative segment of the market of all publicly traded common stocks in the United States. The S&P 500 Index is composed of 500 selected common stocks, all of which are listed on the AMEX, the NYSE or NASDAQ and spans over 105 separate industry groups. Since 1968, the S&P 500 Index has been a component of the U.S. Commerce Department's list of Leading Indicators which track key sectors of the U.S. economy. Current information regarding the market value of the S&P 500 Index is available from market information services. The S&P 500 Index is determined, comprised and calculated without regard to the Trust.

The Sponsor has been granted a license to use the S&P 500 Index as a basis for determining the composition of the Trust and to use certain trademarks of Standard & Poor's in connection with the Trust (see "License Agreement"). Standard & Poor's is not responsible for and shall not participate in the creation or sale of SPDRs or in the determination of the timing of, prices at, or quantities and proportions in which purchases or sales of Index Securities or Securities shall be made. The information in

this Prospectus concerning S&P and the S&P 500 Index has been obtained from sources that the Sponsor believes to be reliable, but the Sponsor takes no responsibility for the accuracy of such information.

The following table shows the actual performance of the S&P 500 Index for the years 1960 through 1998. Stock prices fluctuated widely during this period and were higher at the end than at the beginning. The results shown should not be considered as a representation of the income yield or capital gain or loss that may be generated by the S&P 500 Index in the future, nor should the results be considered as a representation of the performance of the Trust.

Year	Calendar Year-End Index Value*	Calendar Year-End Index Value 1960=100	Change in Index For Calendar Year	Average Yield For Calendar Year**
1960 .....	58.11	100.00	— %	3.47%
1961 .....	71.55	123.13	23.13	2.98
1962 .....	63.10	108.59	- 11.81	3.37
1963 .....	75.02	129.10	18.89	3.17
1964 .....	84.75	145.84	12.97	3.01
1965 .....	92.43	159.06	9.06	3.00
1966 .....	80.33	138.24	- 13.09	3.40
1967 .....	96.47	166.01	20.09	3.20
1968 .....	103.86	178.73	7.66	3.07
1969 .....	92.06	158.42	- 11.36	3.24
1970 .....	92.15	158.58	0.10	3.83
1971 .....	102.09	175.68	10.79	3.14
1972 .....	118.05	203.15	15.63	2.84
1973 .....	97.55	167.87	- 17.37	3.06
1974 .....	68.56	117.98	- 29.72	4.47
1975 .....	90.19	155.21	31.55	4.31
1976 .....	107.46	184.93	19.15	3.77
1977 .....	95.10	163.66	- 11.50	4.62
1978 .....	96.11	165.39	1.06	5.28
1979 .....	107.94	185.75	12.31	5.47
1980 .....	135.76	233.63	25.77	5.26
1981 .....	122.55	210.89	- 9.73	5.20
1982 .....	140.64	242.02	14.76	5.81
1983 .....	164.93	283.82	17.27	4.40
1984 .....	167.24	287.80	1.40	4.64
1985 .....	211.28	363.59	26.33	4.25
1986 .....	242.17	416.75	14.62	3.49
1987 .....	247.08	425.19	2.03	3.08
1988 .....	277.72	477.92	12.40	3.64
1989 .....	353.40	608.15	27.25	3.45
1990 .....	330.22	568.26	- 6.56	3.61
1991 .....	417.09	717.76	26.31	3.24
1992 .....	435.71	749.80	4.46	2.99
1993 .....	464.45	802.70	7.06	2.78
1994 .....	459.27	790.34	- 1.54	2.82
1995 .....	615.93	1059.92	34.11	2.56
1996 .....	740.74	1274.70	20.26	2.19
1997 .....	970.43	1,669.99	31.01	1.77
1998 .....	1,229.23	2,115.35	26.67	1.49

\* Source: Standard & Poor's. Year-end index values shown do not reflect reinvestment of dividends nor costs, such as brokerage charges and transaction costs.

\*\* Source: Standard & Poor's. Yields are obtained by dividing the aggregate cash dividends by the aggregate market value of the stocks in the S&P 500 Index.

It is the understanding of the Sponsor that Standard & Poor's weights the Index Securities primarily based on each stock's relative total market value; that is, its market price per share times the number of shares outstanding. Accordingly, each Index Security's influence on the value of the S&P 500 Index is directly proportionate to its market value. The percentage of the Trust's assets invested in each of the Securities is calculated to approximate the percentage each Index Security represents in the S&P 500 Index.

#### **LICENSE AGREEMENT**

Under the terms of a license agreement with Standard & Poor's (the "License Agreement"), the Sponsor has been granted a license to use the S&P 500 Index as a basis for determining the composition of the Trust and to use certain trade names and trademarks of Standard & Poor's in connection with the Trust. The License Agreement may be amended by the parties thereto without the consent of any of the Beneficial Owners of SPDRs. Currently, the License Agreement is scheduled to expire on January 22, 2018, in accordance with its terms. The parties thereto may extend the term of the License Agreement beyond such date without the consent of any of the Beneficial Owners of SPDRs.

None of the Trust, the Trustee, the Distributor, the Depository or any Beneficial Owner of SPDRs is entitled to any rights whatsoever under the foregoing licensing arrangements or to use the trademarks "S&P", "Standard & Poor's", "Standard & Poor's 500" or "S&P 500" or to use the S&P 500 Index except as specifically described herein or as may be specified in the Trust Agreement.

The Trust is not sponsored, endorsed, sold or promoted by Standard & Poor's and Standard & Poor's makes no representation or warranty, express or implied, to the Trust, the Trustee, the Distributor, the Depository or Beneficial Owners of SPDRs regarding the advisability of investing in Index Securities or unit investment trusts generally or in the Trust particularly or the ability of the S&P 500 Index to track general stock market performance. Standard & Poor's only relationship to the Trust is the licensing of certain trademarks and trade names of Standard & Poor's and of the S&P 500 Index which is determined, comprised and calculated by Standard & Poor's without regard to the Trust or the Beneficial Owners of SPDRs. Standard & Poor's has no obligation to take the needs of the Trust or the Beneficial Owners of SPDRs into consideration in determining, comprising or calculating the S&P 500 Index. Standard & Poor's is not responsible for and has not participated in any determination or calculation made with respect to issuance or redemption of SPDRs. Standard & Poor's has no obligation or liability in connection with the administration, marketing or trading of SPDRs.

**STANDARD & POOR'S DOES NOT GUARANTEE THE ACCURACY AND/OR THE COMPLETENESS OF THE S&P 500 INDEX OR ANY DATA**

INCLUDED THEREIN. STANDARD & POOR'S MAKES NO WARRANTY, EXPRESS OR IMPLIED, AS TO RESULTS TO BE OBTAINED BY THE SPONSOR, THE TRUST, BENEFICIAL OWNERS OF SPDRS OR ANY OTHER PERSON OR ENTITY FROM THE USE OF THE S&P 500 INDEX OR ANY DATA INCLUDED THEREIN IN CONNECTION WITH THE USE LICENSED UNDER THE LICENSE AGREEMENT, OR FOR ANY OTHER USE. STANDARD & POOR'S MAKES NO EXPRESS OR IMPLIED WARRANTIES, AND EXPRESSLY DISCLAIMS ALL SUCH WARRANTIES, INCLUDING WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, WITH RESPECT TO THE S&P 500 INDEX OR ANY DATA INCLUDED THEREIN. WITHOUT LIMITING ANY OF THE FOREGOING, IN NO EVENT SHALL STANDARD & POOR'S HAVE ANY LIABILITY FOR ANY SPECIAL, PUNITIVE, INDIRECT OR CONSEQUENTIAL DAMAGES (INCLUDING LOST PROFITS) EVEN IF NOTIFIED OF THE POSSIBILITY OF SUCH DAMAGES.

#### EXCHANGE LISTING

As described above, SPDRs are listed on the Exchange. Transactions involving SPDRs in the public trading market are subject to customary brokerage charges and commissions.

The Sponsor's aim in designing SPDRs was to provide investors with a security whose market value would approximate one-tenth ( $\frac{1}{10}$ th) the value of the S&P 500 Index. Thus, for example, if the S&P 500 Index were at 900, investors might expect a SPDR to trade at approximately \$90. Note, however, that the market price of a SPDR should also reflect its share of the dividends accumulated on the Securities (see "Administration of the Trust—Distributions to Beneficial Owners") and may also be affected by supply and demand, market volatility, sentiment and other factors.

There can be no assurance that SPDRs will always be listed on the Exchange. The Exchange will consider the suspension of trading in or removal from listing of SPDRs:

- (a) if the Trust has more than 60 days remaining until termination and there are fewer than 50 record and/or beneficial holders of SPDRs for 30 or more consecutive trading days;
- (b) if the S&P 500 Index is no longer calculated or available; or
- (c) if such other event shall occur or condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable.

The Trust is not required to pay a listing fee to the Exchange.

The Trust will be terminated in the event that SPDRs are delisted (see "Administration of the Trust—Termination").

## **TAX STATUS OF THE TRUST**

Effective September 30, 1997, the Trust changed from a calendar year ending on each December 31 to a fiscal year ending each September 30. For the fiscal year ended September 30, 1998, the Trust believes that it qualified for tax treatment as a "regulated investment company" under Subchapter M of the Code. The Trust intends to continue to so qualify. To qualify as a regulated investment company, the Trust must, among other things, (a) derive in each taxable year at least 90% of its gross income from dividends, interest, gains from the sale or other disposition of stock, securities or foreign currencies, or certain other sources, (b) meet certain diversification tests, and (c) distribute in each year at least 90% of its investment company taxable income. If the Trust qualifies as a regulated investment company, subject to certain conditions and requirements, the Trust will not be subject to federal income tax to the extent its income is distributed in a timely manner. Any undistributed income may be subject to tax, including a four percent (4%) excise tax imposed by section 4982 of the Code on certain undistributed income of a regulated investment company that does not distribute to shareholders in a timely manner at least ninety-eight percent (98%) of its taxable income (including capital gains).

### **Tax Consequences to Beneficial Owners**

Dividends paid by the Trust from its investment company taxable income (which includes dividends, interest and the excess of net short-term capital gains over net long-term capital losses) will be taxable to Beneficial Owners as ordinary income. A dividend paid in January will be considered for federal income tax purposes to have been paid by the Trust and received by Beneficial Owners on the preceding December 31 if the dividend was declared in the preceding October, November or December to Beneficial Owners of record as shown on the records of the Depository and the DTC Participants (see "The Trust—Book-Entry-Only System") on a date in one of those months.

Distributions paid by the Trust from the excess of net long-term capital gains over net short-term capital losses are considered "capital gains dividends" regardless of the length of time an investor has owned SPDRs. Any loss on the sale or exchange of a share held for six months or less may be treated as a long-term capital loss to the extent of any capital gain dividends received by the Beneficial Owner. For corporate investors, dividends from net investment income (but not return of capital distributions or capital gain dividends) generally will qualify for the corporate dividends-received deduction to the extent of qualifying dividend income received by the Trust, subject to the limitations contained in the Code. Investors should note that the regular quarterly dividends paid by the Trust will not be based on the Trust's investment company taxable income and net capital gain, but rather will be based on the dividends paid with respect to the Securities. As a result, a portion of the distributions

of the Trust may be treated as a return of capital or a capital gain dividend for federal income tax purposes or the Trust may make additional distributions in excess of the yield performance of the Securities in order to distribute all of its investment company taxable income and net capital gain.

Distributions in excess of the Trust's current or accumulated earnings and profits (as specially computed) generally will be treated as a return of capital for federal income tax purposes and will reduce a Beneficial Owner's tax basis in SPDRs. Return of capital distributions may result, for example, if a portion of the dividends declared represents cash amounts deposited in connection with Portfolio Deposits rather than dividends actually received by the Trust. Under certain circumstances, a significant portion of the Trust's regular quarterly dividends could be treated as return of capital distributions. Such circumstances may be more likely to occur in periods during which the number of outstanding SPDRs fluctuates significantly, as may occur during the initial years of the Trust. Beneficial Owners will receive annually notification from the Trustee through the DTC Participants as to the tax status of the Trust's distributions (see "The Trust—Book-Entry-Only System"). A distribution paid shortly after a purchase or creation of SPDRs may be taxable even though in effect it may represent a return of capital. Capital gains realized by non-corporate taxpayers are generally taxable at a maximum rate of 20% if the taxpayer has a holding period of more than twelve months.

Distributions reinvested in additional SPDRs through the means of the Service (see "Dividend Reinvestment Service") will nevertheless be taxable dividends to Beneficial Owners acquiring such additional SPDRs to the same extent as if such dividends had been received in cash.

The sale of SPDRs by a Beneficial Owner is a taxable event, and may result in a gain or loss, which generally should be a capital gain or loss for Beneficial Owners that are not dealers in securities.

Under the Code, an in-kind redemption of SPDRs will not result in the recognition of taxable gain or loss by the Trust but generally will constitute a taxable event for the redeeming shareholder. Upon redemption, a Beneficial Owner generally will recognize gain or loss measured by the difference on the date of redemption between the aggregate value of the cash and securities received and its tax basis in the SPDRs redeemed. Securities received upon redemption (which will be comprised of the securities portion of the Portfolio Deposit in effect on the date of redemption) generally will have an initial tax basis equal to their respective market values on the date of redemption. The Internal Revenue Service ("IRS") may assert that any resulting loss may not be deducted by a Beneficial Owner on the basis that there has been no material change in such Beneficial Owner's economic position or that the transaction has no significant economic or business utility apart from the anticipated

tax consequences. Beneficial Owners of SPDRs in Creation Unit size aggregations should consult their own tax advisors as to the consequences to them of the redemption of SPDRs.

Dividend distributions, capital gains distributions, and capital gains from sales or redemptions may also be subject to state, local and foreign taxes.

Deposit of a Portfolio Deposit with the Trustee in exchange for SPDRs in Creation Unit size aggregations will not result in the recognition of taxable gain or loss by the Trust but generally will constitute a taxable event to the depositor under the Code, and a depositor generally will recognize gain or loss with respect to each security deposited equal to the difference between the amount realized in respect of the security and the depositor's tax basis therein. The amount realized with respect to a security deposited should be determined by allocating the value on the date of deposit of the SPDRs received (less any cash paid to the Trust, or plus any cash received from the Trust, in connection with the deposit) among the securities deposited on the basis of their respective fair market values at that time. The IRS may assert that any resulting losses may not be deducted by a depositor on the basis that there has been no material change in the depositor's economic position or that the transaction has no significant economic or business utility or purpose apart from the anticipated tax consequences. Depositors should consult their own tax advisors as to the tax consequences to them of a deposit to the Trust.

The Trustee has the right to reject the order to create Creation Units transmitted to it by the Distributor if the depositor or group of depositors, upon obtaining the SPDRs ordered, would own eighty percent (80%) or more of the outstanding SPDRs, and if pursuant to section 351 of the Code such a circumstance would result in the Trust having a basis in the securities deposited different from the market value of such securities on the date of deposit. The Trustee has the right to require information regarding SPDR ownership pursuant to the Participant Agreement and from the Depository and to rely thereon to the extent necessary to make the foregoing determination as a condition to the acceptance of a Portfolio Deposit.

Ordinary income dividends received via the Depository by Beneficial Owners who are non-resident aliens will be subject to a thirty percent (30%) United States withholding tax unless a reduced rate of withholding or a withholding exemption is provided under applicable tax treaties. Non-resident shareholders are urged to consult their own tax advisors concerning the applicability of United States withholding tax.

Backup withholding at a rate of 31% will apply to dividends, capital gain distributions, redemptions and sales of SPDRs unless (a) the Beneficial Owner is a corporation or comes within certain other exempt categories and, when required, demonstrates this fact, or (b) provides a taxpayer identification number, certifies as to no loss of exemption from backup withholding, and otherwise complies with



applicable requirements of the backup withholding rules. The amount of any backup withholding from a payment to a Beneficial Owner will be allowed as a credit against the holder's U.S. federal income tax liability and may entitle such holder to a refund from the U.S. Internal Revenue Service, provided that the required information is furnished to the U.S. Internal Revenue Service.

The tax discussion set forth above is included for general information only. Prospective investors should consult their own tax advisors concerning the federal, state, local and foreign tax consequences to them of an investment in the Trust, including the effect of possible legislative changes.

### CONTINUOUS OFFERING OF SPDRs

SPDRs in Creation Unit size aggregations are offered continuously to the public by the Trust through the Distributor and are delivered upon the deposit of a Portfolio Deposit (see "The Trust—Procedure for Creation of Creation Units"). A list of the identity and number of shares of each of the Index Securities in the current Portfolio Deposit and the amount of the Dividend Equivalent Payment effective through and including the previous Business Day is made available by the Trustee to NSCC on each Business Day. Under certain extraordinary circumstances which may make it impossible for the Trustee to provide such information to NSCC on a given Business Day, NSCC shall use the composition and weighting of the Index Securities for the most recently effective Portfolio Deposit. The minimum number of SPDRs that may be created as described herein is 50,000 or one Creation Unit. Persons making Portfolio Deposits and creating Creation Unit aggregations of SPDRs will receive no fees, commissions or other form of compensation or inducement of any kind from the Sponsor or the Distributor, nor will any such person have any obligation or responsibility to the Sponsor or Distributor to effect any sale or resale of SPDRs.

Because new SPDRs can be created and issued on an ongoing basis, at any point during the life of the Trust a "distribution", as such term is used in the Securities Act of 1933, may be occurring. Broker-dealers and other persons are cautioned that some activities on their part may, depending on the circumstances, result in their being deemed participants in a distribution in a manner which could render them statutory underwriters and subject them to the prospectus-delivery and liability provisions of the Securities Act. For example, a broker-dealer firm or its client may be deemed a statutory underwriter if it takes Creation Units after placing a creation order with the Distributor, breaks them down into the constituent SPDRs and sells the SPDRs directly to its customers; or if it chooses to couple the creation of a supply of new SPDRs with an active selling effort involving solicitation of secondary market demand for SPDRs. A determination of whether one is an underwriter must take into account all the facts and circumstances pertaining to the activities of the broker-dealer or its

client in the particular case, and the examples mentioned above should not be considered a complete description of all the activities that could lead to categorization as an underwriter.

Dealers who are not "underwriters" but are participating in a distribution (as contrasted to ordinary secondary trading transactions), and thus dealing with SPDRs that are part of an "unsold allotment" within the meaning of Section 4(3)(C) of the Securities Act, would be unable to take advantage of the prospectus-delivery exemption provided by Section 4(3) of the Securities Act. Firms that do incur a prospectus delivery obligation with respect to SPDRs are reminded that under Securities Act rule 153, a prospectus-delivery obligation under Section 5(b)(2) of the Act owed to an Exchange member in connection with a sale on the Exchange is satisfied by the fact that SPDR prospectuses will be available at the Exchange upon request. Of course, the prospectus-delivery mechanism provided in rule 153 is only available with respect to transactions on an exchange.

The Sponsor intends to qualify SPDRs in states selected by the Sponsor and through broker-dealers who are members of the National Association of Securities Dealers, Inc. Investors intending to create or redeem Creation Unit size aggregations of SPDRs in transactions not involving a broker-dealer registered in such investor's state of domicile or residence should consult counsel regarding applicable broker-dealer or securities regulatory requirements under such state securities laws prior to such creation or redemption.

#### **EXPENSES OF THE TRUST**

Ordinary operating expenses of the Trust are currently being accrued at an annual rate of 0.18%; future accruals will depend primarily on the level of the Trust's net assets and the level of Trust expenses. There is no guarantee that the Trust's ordinary operating expenses will not exceed 0.18% of the Trust's daily net asset value and such rate may be changed without notice.

Until further notice, the Sponsor has undertaken that the ordinary operating expenses of the Trust as calculated by the Trustee will not be permitted to exceed an amount which is 18.45/100 of 1% (0.1845%) per annum of the daily net asset value of the Trust. To the extent during such period the ordinary operating expenses of the Trust do exceed such 0.1845% amount, the Sponsor will reimburse the Trust for or assume such excess ordinary operating expenses. The Sponsor retains the ability to be repaid by the Trust for expenses so reimbursed or assumed to the extent that subsequently during the fiscal year expenses fall below the 0.1845% per annum level on any given day. For purposes of this undertaking by the Sponsor, ordinary operating expenses of the Trust shall not include taxes, brokerage commissions and, of course, such extraordinary non-recurring expenses as may arise, including without limitation the cost of any litigation to which the Trust or Trustee may be a party. The Sponsor

may discontinue this undertaking or renew it for specified period of time, or may choose to reimburse or assume certain Trust expenses in later periods in order to keep Trust expenses at a level it believes to be attractive to investors, but is not obligated to do so. In any event, it is possible that, on any day and during any period over the life of the Trust, total fees and expenses of the Trust may exceed 0.1845% per annum.

Subject to any applicable cap, the Sponsor reserves the right to charge the Trust a special sponsor fee from time to time in reimbursement for certain services it may provide to the Trust which would otherwise be provided by the Trustee in an amount not to exceed the actual cost of providing such services. The Sponsor or the Trustee from time to time may voluntarily assume some expenses or reimburse the Trust so that total expenses of the Trust are reduced, although neither the Sponsor nor the Trustee is obligated to do so and either one or both parties may discontinue such voluntary assumption of expenses or reimbursement at any time without notice.

The following charges are or may be accrued and paid by the Trust: (a) the Trustee's fee as discussed more fully below, (b) fees payable to transfer agents for the provision of transfer agency services; (c) fees of the Trustee for extraordinary services performed under the Trust Agreement; (d) various governmental charges; (e) any taxes, fees and charges payable by the Trustee with respect to SPDRs (whether in Creation Unit size aggregations or otherwise); (f) expenses and costs of any action taken by the Trustee or the Sponsor to protect the Trust and the rights and interests of Beneficial Owners of SPDRs (whether in Creation Unit size aggregations or otherwise); (g) indemnification of the Trustee or the Sponsor for any losses, liabilities or expenses incurred by it in the administration of the Trust without gross negligence, bad faith, wilful misconduct or wilful malfeasance on its part or reckless disregard of its obligations and duties; (h) expenses incurred in contacting Beneficial Owners of SPDRs during the life of the Trust and upon termination of the Trust; and (i) other out-of-pocket expenses of the Trust incurred pursuant to actions permitted or required under the Trust Agreement.

In addition to the specific expenses discussed in the previous paragraph, discussed above, the following expenses are or may be charged to the Trust: (a) reimbursement to the Sponsor of amounts paid by it to S&P in respect of annual licensing fees pursuant to the License Agreement (see "License Agreement"), (b) federal and state annual registration fees for the issuance of SPDRs, and (c) expenses of the Sponsor relating to the printing and distribution of marketing materials describing SPDRs and the Trust (including, but not limited to, associated legal, consulting, advertising, and marketing costs and other out-of-pocket expenses such as printing). In addition, initial fees and expenses totaling approximately \$549,500, in connection with the organization of the Trust, were capitalized and have been amortized over five years from the start of the Trust's operations on a straight-line basis and charged to the Trust. Pursuant to the provisions of an exemptive order, the

expenses set forth in this paragraph may be charged to the Trust by the Trustee in an amount equal to the actual costs incurred, but in no case shall such charges exceed 20/100 of 1% (0.20%) per annum of the daily net asset value of the Trust.

If the income received by the Trust in the form of dividends and other distributions on the Securities is insufficient to cover Trust expenses, the Trustee may make advances to the Trust to cover such expenses; otherwise the Trustee may sell Securities in an amount sufficient to pay such expenses. The Trustee may reimburse itself in the amount of any such advance, together with interest thereon at a percentage rate equal to the then current overnight federal funds rate, by deducting such amounts from (1) dividend payments or other income of the Trust when such payments or other income is received, (2) the amounts earned or benefits derived by the Trustee on cash held by the Trustee for the benefit of the Trust, and (3) the sale of Securities. Notwithstanding the foregoing, in the event that any advance remains outstanding for more than forty-five (45) Business Days, the Trustee may sell Securities to reimburse itself for the amount of such advance and any accrued interest thereon. Such advances will be secured by a lien on the assets of the Trust in favor of the Trustee. The expenses of the Trust are reflected in the net asset value of the Trust (see "Valuation").

For services performed under the Trust Agreement, the Trustee is paid by the Trust a fee at an annual rate of 11/100 of 1% to 15/100 of 1% of the net asset value of the Trust, as shown below, such percentage amount to vary depending on the net asset value of the Trust, plus or minus the Adjustment Amount (as hereinafter defined). Such compensation is computed on each Business Day on the basis of the net asset value of the Trust on such day, and the amount thereof is accrued daily and paid monthly. To the extent that the amount of the Trustee's compensation, prior to any adjustment in respect of the Adjustment Amount, is less than specified amounts, the Sponsor has agreed to pay the amount of any such shortfall. The Trustee, in its discretion, may also waive all or a portion of such fee.

#### TRUSTEE FEE SCALE

<u>Net Asset Value of the Trust</u>	<u>Fee as a Percentage of Net Asset Value of the Trust</u>
\$0-\$499,999,999 . . . . .	15/100 of 1% per annum plus or minus the Adjustment Amount
\$500,000,000-\$999,999,999 . .	13/100 of 1% per annum plus or minus the Adjustment Amount*
\$1,000,000,000 and above . . .	11/100 of 1% per annum plus or minus the Adjustment Amount*

\* The fee indicated applies to that portion of the net asset value of the Trust which falls in the size category indicated.

As of September 30, 1998, and as of December 31, 1998 the net asset value of the Trust was \$8,069,344,125 and \$12,175,289,421, respectively. No representation is made as to the actual net asset value of the Trust on any future date, as it is subject to change at any time due to fluctuations in market value of Securities or to creations or redemptions made in the future.

The Adjustment Amount shall be calculated at the end of each quarter and applied against the Trustee's fee for the following quarter. The "Adjustment Amount" is an amount which is intended, depending upon the circumstances, either to (1) reduce the Trustee's fee by the amount that the Transaction Fees paid on creation and redemption exceeds the costs of those activities, and by the amount of excess earnings on cash held for the benefit of the Trust or (2) increase the Trustee's fee by the amount that the Transaction Fee (plus additional amounts paid in connection with creations or redemptions outside the SPDR Clearing Process), if any, paid on creations or redemptions, falls short of the actual costs of these activities. If in any quarter the Adjustment Amount exceeds the fee payable to the Trustee as set forth above, the Trustee shall use such excess amount to reduce other Trust expenses, subject to certain federal tax limitations. To the extent that the amount of such excess exceeds the Trust's expenses for such quarter, any remaining excess shall be retained by the Trustee as part of its compensation. If in any quarter the costs of processing creations and redemptions exceed the amounts charged as a Transaction Fee (plus the additional amounts paid in connection with creations or redemptions outside the SPDR Clearing Process) net of the excess earnings, if any, on cash held for the benefit of the Trust, the Trustee will augment the Trustee's fee by the resulting Adjustment Amount.

#### **REDEMPTION OF SPDRS**

SPDRs in Creation Unit size aggregations are redeemable in kind only and are not redeemable for cash. SPDRs in Creation Unit size aggregations may be redeemed by submitting a request for redemption, the requisite number of SPDRs and the Excess Cash Amount (as defined below), if applicable, to the Trustee in the manner specified below. Beneficial Owners of SPDRs may sell SPDRs in the secondary market, but must accumulate enough SPDRs to constitute a Creation Unit (*i.e.*, 50,000 SPDRs) in order to redeem through the Trust. SPDRs can be redeemed only when Creation Unit size aggregations are owned by a Beneficial Owner and held in the account of a single Participating Party (with respect to redemptions through the SPDR Clearing Process) or a single DTC Participant (with respect to redemptions outside the SPDR Clearing Process). SPDRs will remain outstanding until redeemed or until the termination of the Trust.

#### **Procedure for Redemption of SPDRs**

Requests for redemptions of Creation Units may be made on any Business Day through the SPDR Clearing Process to the Trustee at its Quincy office or at such other

office as may be designated by the Trustee. Requests for redemptions of Creation Units may also be made directly to the Trustee outside the SPDR Clearing Process. Requests for redemption shall not be made to the Distributor. In the case of redemptions made through the SPDR Clearing Process, the Transaction Fee will be deducted from the amount delivered to the redeemer. In case of redemptions tendered directly to the Trustee outside the SPDR Clearing Process, a total fee will be charged on a per Creation Unit basis per day. Such fee will be equal to the Transaction Fee plus an additional amount not to exceed three (3) times the Transaction Fee applicable for one Creation Unit per Creation Unit redeemed, (due in part to the increased expense associated with delivery outside the SPDR Clearing Process) and such amount will be deducted from the amount delivered to the redeemer (see "Prospectus Summary—Transaction Fee"). In all cases, both the tender of SPDRs for redemption and distributions to the redeemer in respect of SPDRs redeemed will be effected through the Depository and the relevant DTC Participant(s) to the Beneficial Owner thereof as recorded on the book entry system of the Depository or the relevant DTC Participant, as the case may be (see "The Trust—Book-Entry-Only System").

The Trustee will transfer to the redeeming Beneficial Owner via the Depository and the relevant DTC Participant(s) a portfolio of Securities for each Creation Unit size aggregation of SPDRs delivered, identical in weighting and composition to the securities portion of a Portfolio Deposit as in effect (1) on the date a request for redemption is deemed received by the Trustee as described below, in the case of redemptions made either through the SPDR Clearing Process or outside the SPDR Clearing Process or (2) on the date that notice of the termination of the Trust is given, in the case of the termination of the Trust (see "Administration of the Trust—Termination" and "The Portfolio—Adjustments to the Portfolio"). The Trustee will also transfer via the relevant DTC Participant(s) to the redeeming Beneficial Owner in cash the "Cash Redemption Payment", which on any given Business Day is an amount identical to the amount of the Cash Component and is equal to a proportional amount of the following: dividends on all the Securities for the period through the date of redemption, net of expenses and liabilities for such period including, without limitation, (x) taxes or other governmental charges against the Trust not previously deducted if any, and (y) accrued fees of the Trustee and other expenses of the Trust (including legal and auditing expenses) and other expenses not previously deducted (see "Expenses of the Trust"), as if all the Securities had been held for the entire accumulation period for such distribution, plus or minus the Balancing Amount. To the extent that any amounts payable to the Trust by the redeeming Beneficial Owner exceed the amount of the Cash Redemption Payment ("Excess Cash Amounts"), such Beneficial Owner shall be required to deliver payment thereof to the Trustee. In the case of redemptions made through the SPDR Clearing Process, the Trustee will effect a transfer of the Cash Redemption Payment and Securities to the redeeming Beneficial Owner by the third (3rd) NSCC Business Day following the date on which request for redemption is deemed received. In the case of redemptions made outside the SPDR

Clearing Process, the Trustee will transfer the Cash Redemption Payment and the securities to the redeeming Beneficial Owner by the third (3rd) Business Day following the date on which the request for redemption is deemed received. The Trustee will cancel all SPDRs delivered upon redemption.

In the event that the Trustee determines in its discretion that an Index Security is likely to be unavailable or available in insufficient quantity for delivery by the Trust upon the redemption of SPDRs in Creation Unit size aggregations, the Trustee shall have the right in its discretion to deliver the cash equivalent value of such Index Security or Index Securities, based on the market value of such Index Security or Index Securities as of the Evaluation Time on the date such redemption is deemed received by the Trustee (see "Placement of Redemption Orders Using SPDR Clearing Process") as a part of the Cash Redemption Payment in lieu of delivering such Index Security or Index Securities to the redeemer.

In connection with the redemption of SPDRs, if a redeemer is restricted by regulation or otherwise from investing or engaging in a transaction in one or more Index Securities, the Trustee shall have the right in its discretion to deliver the cash equivalent value of such Index Security or Index Securities based on the market value of such Index Security or Index Securities as of the Evaluation Time on the date such redemption order is deemed received by the Trustee (see "Placement of Redemption Orders Outside SPDR Clearing Process") as a part of the Cash Redemption Payment in lieu of delivering such Index Security or Index Securities to the redeemer. In such case, such investor will pay the Trustee the standard Transaction Fee, plus an additional amount equal to the actual amounts incurred in connection with such transaction(s) but in any case not to exceed three (3) times the Transaction Fee applicable for one Creation Unit (see "Prospectus Summary—Transaction Fee").

The Trustee, in its discretion, upon the request of a redeeming investor, may redeem Creation Units in whole or in part by providing such redeemer with a portfolio of Securities differing in exact composition from the Index Securities but not differing in net asset value from the then-current Portfolio Deposit. Such a redemption is likely to be made only if it were determined that it would be appropriate in order to maintain the Trust's correspondence to the composition and weighting of the S&P 500 Index, for instance, in connection with the replacement of one of the Index Securities.

The Trustee may sell Securities to obtain sufficient cash proceeds to deliver to the redeeming Beneficial Owner. To the extent cash proceeds are received by the Trustee in excess of the amount required to be provided to the redeeming Beneficial Owner, such cash amounts shall be held by the Trustee and shall be applied in accordance with the guidelines applicable to Misweightings (see "The Portfolio—Adjustments to the Portfolio").

If the income received by the Trust in the form of dividends and other distributions on the Securities is insufficient to allow distribution of the Cash Redemption Payment, the Trustee may advance out of its own funds any amounts necessary in respect of redemptions of SPDRs; otherwise, the Trustee may sell

Securities in an amount sufficient to effect such redemptions. The Trustee may reimburse itself in the amount of such advance, together with interest thereon at a percentage rate equal to the then current overnight federal funds rate, by deducting such amounts from (1) dividend payments or other income of the Trust when such payments or other income is received, (2) the amounts earned or benefits derived by the Trustee on cash held by the Trustee for the benefit of the Trust, and (3) the sale of Securities. Notwithstanding the foregoing, in the event that any advance remains outstanding for more than forty-five (45) Business Days, the Trustee shall sell Securities to reimburse itself for such advance and any accrued interest thereon. Such advances will be secured by a lien on the assets of the Trust in favor of the Trustee.

The Trustee may, in its discretion, and will when so directed by the Sponsor, suspend the right of redemption, or postpone the date of payment of the net asset value for more than five (5) Business Days following the date on which the request for redemption is deemed received by the Trustee; for any period during which the New York Stock Exchange is closed; for any period during which an emergency exists as a result of which disposal or evaluation of the Securities is not reasonably practicable; or for such other period as the Commission may by order permit for the protection of Beneficial Owners. Neither the Sponsor nor the Trustee is liable to any person or in any way for any loss or damages which may result from any such suspension or postponement.

To be eligible to place orders with the Trustee to redeem SPDRs in Creation Unit size aggregations, an entity or person must be (1) a Participating Party with respect to redemptions through the SPDR Clearing Process, or (2) a DTC Participant with respect to redemptions outside the SPDR Clearing Process and, in either event, have executed a Participant Agreement.

All orders to redeem SPDRs must be placed in multiples of 50,000 SPDRs (Creation Unit size). Orders must be transmitted to the Trustee by telephone or other transmission method acceptable to the Trustee so as to be received by the Trustee not later than the Closing Time on the Transmittal Date, pursuant to procedures set forth in the Participant Agreement. Severe economic or market disruption or changes, or telephone or other communication failure, may impede the ability to reach the Trustee, a Participating Party, or a DTC Participant.

Orders to redeem Creation Unit size aggregations of SPDRs shall be placed with a Participating Party or DTC Participant, as applicable, in the form required by such Participating Party or DTC Participant. Investors should be aware that their particular broker may not have executed a Participant Agreement, and that, therefore, orders to redeem Creation Unit size aggregations of SPDRs may have to be placed by the investor's broker through a Participating Party or a DTC Participant who has executed a Participant Agreement. At any given time there may be only a limited number of broker-dealers that have executed a Participant Agreement. Those placing orders to redeem SPDRs should afford sufficient time to permit (1) proper submission of the



order by a Participating Party or DTC Participant to the Trustee and (2) the receipt of the SPDRs to be redeemed and the Excess Cash Amounts, if any, by the Trustee in a timely manner, as described below. Orders for redemption that are effected outside the SPDR Clearing Process are likely to require transmittal by the DTC Participant earlier on the Transmittal Date than orders effected using the SPDR Clearing Process. Those persons placing orders outside the SPDR Clearing Process should ascertain the deadlines applicable to DTC and the Federal Reserve Bank wire transfer system by contacting the operations department of the broker or depository institution effectuating such transfer of SPDRs and Cash Redemption Payment. These deadlines will vary by institution. The Participant notified of an order to redeem outside the SPDR Clearing Process will be required to transfer SPDRs through DTC and the Excess Cash amounts, if any, through the Federal Reserve Bank wire transfer system in a timely manner (see "Placement of Redemption Orders Outside the SPDR Clearing Process"). Information regarding Cash Redemption Payment amounts, number of outstanding SPDRs and Transaction Fees may be obtained from the Trustee at the toll-free number: 1-800-545-4189.

#### **Placement of Redemption Orders Using SPDR Clearing Process**

Orders to redeem SPDRs in Creation Unit size aggregations through the SPDR Clearing Process must be delivered through a Participating Party (see "Portfolio Deposit") that has executed the Participant Agreement with the Distributor and with the Trustee (as the same may be from time to time amended in accordance with its terms). An order to redeem SPDRs using the SPDR Clearing Process is deemed received on the Transmittal Date if (i) such order is received by the Trustee not later than the Closing Time on such Transmittal Date and (ii) all other procedures set forth in the Participant Agreement are properly followed; such order will be effected based on the net asset value of the Trust as determined as of the Evaluation Time on the Transmittal Date. An order to redeem SPDRs using the SPDR Clearing Process made in proper form but received by the Trustee after the Closing Time will be deemed received on the next Business Day immediately following the Transmittal Date. The Participant Agreement authorizes the Trustee to transmit to NSCC on behalf of the Participating Party such trade instructions as are necessary to effect the Participating Party's redemption order. Pursuant to such trade instructions from the Trustee to NSCC, the Trustee will transfer the requisite Securities (or contracts to purchase such Securities which are expected to be delivered in a "regular way" manner) by the third (3rd) NSCC Business Day following the date on which such request for redemption is deemed received, and the Cash Redemption Payment. The calculation of the value of the Securities and the Cash Redemption Payment to be delivered by the Trustee to the redeeming Beneficial Owner will be made according to the procedures set forth under "Valuation," computed as of the Evaluation Time on the Business Day on which a redemption order is deemed received by the Trustee.

### **Placement of Redemption Orders Outside SPDR Clearing Process**

Orders to redeem SPDRs outside the SPDR Clearing Process must be delivered through a DTC Participant that has executed the Participant Agreement with the Distributor and with the Trustee. A DTC Participant who wishes to place an order for redemption of SPDRs to be effected outside the SPDR Clearing Process need not be a Participating Party, but such orders must state that the DTC Participant is not using the SPDR Clearing Process and that redemption of SPDRs will instead be effected through transfer of SPDRs directly through DTC. An order to redeem SPDRs outside the SPDR Clearing Process is deemed received by the Trustee on the Transmittal Date if (i) such order is received by the Trustee not later than the Closing Time on such Transmittal Date, (ii) such order is preceded or accompanied by the requisite number of SPDRs specified in such order, which delivery must be made through DTC to the Trustee no later than 11:00 a.m. on the next Business Day immediately following such Transmittal Date (the "DTC Cut-Off Time") and (iii) all other procedures set forth in the Participant Agreement are properly followed. The Excess Cash Amounts owed by the Beneficial Owner, if any, must be delivered no later than 2:00 p.m. on the next Business Day immediately following the Transmittal Date.

After the Trustee has deemed an order for redemption outside the SPDR Clearing Process received, the Trustee will initiate procedures to transfer the requisite Securities (or contracts to purchase such Securities which are expected to be delivered within three Business Days and the Cash Redemption Payment to the redeeming Beneficial Owner by the third Business Day following the Transmittal Date on which such redemption order is deemed received by the Trustee.

The calculation of the value of the Securities and the Cash Redemption Payment to be delivered to the redeeming Beneficial Owner will be made by the Trustee according to the procedures set forth under "Valuation," computed as of the Evaluation Time on the Business Day on which a redemption order is deemed received by the Trustee. Therefore, if a redemption order in proper form is submitted to the Trustee by a DTC Participant not later than the Closing Time on the Transmittal Date, and the requisite SPDRs are delivered to the Trustee prior to the DTC Cut-Off Time on such Transmittal Date, then the value of the Securities and the Cash Redemption Payment to be delivered to the Beneficial Owner will be determined by the Trustee as of the Evaluation Time on such Transmittal Date. If, however, a redemption order is submitted to the Trustee by a DTC Participant not later than the Closing Time on a Transmittal Date but either (1) the requisite SPDRs are not delivered by the DTC Cut-Off Time on the next Business Day immediately following such Transmittal Date or (2) the redemption order is not submitted in proper form, then the redemption order will not be deemed received as of such Transmittal Date. In such case, the value of the Securities and the Cash Redemption Payment to be delivered to the Beneficial Owner will be computed as of the Evaluation Time on the Business Day that such order is deemed received by the Trustee, *i.e.*, the Business Day

on which the SPDRs are delivered through DTC to the Trustee by the DTC Cut-Off Time on such Business Day pursuant to a properly submitted redemption order.

## **VALUATION**

The net asset value of the Trust is computed as of the Evaluation Time shown under “Essential Information” on each Business Day. The net asset value of the Trust on a per SPDR basis is determined by subtracting all liabilities (including accrued expenses and dividends payable) from the total value of the Trust’s investments and other assets and dividing the result by the total number of outstanding SPDRs.

The aggregate value of the Securities shall be determined by the Trustee in good faith in the following manner: If the Securities are listed on one or more national securities exchanges, such evaluation shall generally be based on the closing sale price on that day (unless the Trustee deems such price inappropriate as a basis for evaluation) on the exchange which is deemed to be the principal market therefor (the New York or American Stock Exchange if the securities are listed thereon) or, if there is no such appropriate closing sale price on such exchange, at the closing bid price (unless the Trustee deems such price inappropriate as a basis for evaluation). If the Securities are not so listed or, if so listed and the principal market therefor is other than on such exchange or there is no such closing bid price available, such evaluation shall generally be made by the Trustee in good faith based on the closing price on the over-the-counter market (unless the Trustee deems such price inappropriate as a basis for evaluation) or if there is no such appropriate closing price, (a) on current bid prices, (b) if bid prices are not available, on the basis of current bid prices for comparable securities, (c) by the Trustee’s appraising the value of the securities in good faith on the bid side of the market, or (d) by any combination thereof.

## **ADMINISTRATION OF THE TRUST**

### **Records**

The Trustee maintains records of the transactions of the Trust, including a current list of the identity and number of shares of each of the Securities in the Portfolio. Records of the creation of SPDRs in Creation Unit size aggregations are also maintained by the Distributor. Record of ownership of SPDRs is maintained by the Depository and by DTC Participants as described above (see “The Trust—Book-Entry-Only System”).

A complete copy of the Trust Agreement is maintained by the Trustee. A copy of the Trust Agreement is available to Beneficial Owners at the corporate trust office of the Trustee at 225 Franklin Street, Boston, Massachusetts 02110 during normal business hours.

## **Voting**

The Trustee has the right to vote all of the voting stocks in the Trust. The Trustee votes the voting stocks of each issuer in the same proportionate relationship as all other shares of each such issuer are voted to the extent permissible and, if not permitted, abstains from voting.

## **Distributions to Beneficial Owners**

The regular quarterly ex-dividend date for SPDRs is the third Friday in each of March, June, September and December, unless such day is not a Business Day, in which case the ex-dividend date is the immediately preceding Business Day (the "Ex-Dividend Date"). Beneficial Owners as reflected on the records of the Depository and the DTC Participants on the second Business Day following the Ex-Dividend Date (the "Record Date") are entitled to receive an amount representing dividends accumulated on the Securities through the quarterly dividend period which ends on the Business Day preceding such Ex-Dividend Date (including Securities with ex-dividend dates falling within such quarterly dividend period), net of fees and expenses, accrued daily for such period. For the purposes of all dividend distributions, dividends per SPDR are calculated at least to the nearest 1/100th of \$0.01. The payment of dividends is made on the last Business Day in the calendar month following each Ex-Dividend Date (the "Dividend Payment Date"). Dividend payments will be made through the Depository and the DTC Participants to Beneficial Owners then of record with funds received from the Trustee. SPDRs are registered in book entry only, which records are kept by the Depository (see "The Trust—Book-Entry-Only System").

Dividends payable to the Trust in respect of the Securities are credited by the Trustee to a non-interest bearing account as of the date on which the Trust receives such dividends. Other moneys received by the Trustee in respect of the Securities, including but not limited to the Cash Component, the Cash Redemption Payment, all moneys realized by the Trustee from the sale of options, warrants or other similar rights received or distributed in respect of the Securities as dividends or distributions and capital gains resulting from the sale of Securities are also credited by the Trustee to a non-interest bearing account. All funds collected or received are held by the Trustee without interest until distributed in accordance with the provisions of the Trust Agreement. To the extent the amounts credited to such accounts generate interest income or an equivalent benefit to the Trustee, such interest income or benefit is used to reduce the Trustee's annual fee (see "Expenses of the Trust").

The Trust intends to qualify as a regulated investment company for federal income tax purposes. A regulated investment company is not subject to federal income tax on its net investment income and capital gains that it distributes to shareholders, so long as it meets certain overall distribution and diversification requirements and other conditions under Subchapter M of the Code. The Trust intends to satisfy these

overall distribution and diversification requirements and to otherwise satisfy any required conditions. The Trustee intends to make additional distributions to the minimum extent necessary (i) to distribute the entire annual investment company taxable income of the Trust, plus any net capital gains (from sales of securities in connection with adjustments to the Portfolio or to generate cash for such distributions), and (ii) to avoid imposition of the excise tax imposed by section 4982 of the Code (see "Tax Status of the Trust"). The additional distributions, if needed, would consist of (a) an increase in the distribution scheduled for January to include any amount by which estimated Trust investment company taxable income and net capital gains for a year exceeds the amount of Trust taxable income previously distributed with respect to such year or, if greater, the minimum amount required to avoid imposition of such excise tax, and (b) a distribution soon after actual annual investment company taxable income and net capital gains of the Trust have been computed of the amount, if any, by which such actual income exceeds the distributions already made. The net asset value of the Trust will be reduced in direct proportion to the amount of such additional distributions. The magnitude of the additional distributions, if any, will depend upon a number of factors, including the level of redemption activity experienced by the Trust. Because substantially all proceeds from the sale of securities in connection with adjustments to the Portfolio will have been used to purchase shares of Index Securities, the Trust may have no cash or insufficient cash with which to pay such additional distributions. In that case, the Trustee will have to sell shares of the Securities sufficient to produce the cash required to make such additional distributions. In selecting the Securities to be sold to produce cash for such distributions, the Trustee will choose among the Securities that are over-weighted in the Portfolio relative to their weightings in the S&P 500 Index first and then from among all other Securities in a manner so as to maintain the weightings of the Securities within the applicable Misweighting Amount (see "The Portfolio—Adjustments to the Portfolio").

The Trustee further reserves the right to declare special dividends if, in its reasonable discretion, such action is necessary or advisable to preserve the status of the Trust as a regulated investment company or to avoid imposition of income or excise taxes on undistributed income.

The Trustee further reserves the right to vary the frequency with which periodic distributions are made (*e.g.*, from quarterly to monthly) if it is determined by the Sponsor and the Trustee, in their discretion, that such a variance would be advisable to facilitate compliance with the rules and regulations applicable to regulated investment companies or would otherwise be advantageous to the Trust. In addition, the Trustee reserves the right to change the regular ex-dividend date for SPDRs to another date within the month or quarter if it is determined by the Sponsor and the Trustee, in their discretion, that such a change would be advantageous to the Trust. Notice of any such variance or change (which notice shall include changes to the

Record Date, the Ex-Dividend Date, the Dividend Payment Date, and the accumulation period resulting from such variance) shall be provided to Beneficial Owners via the Depository and the DTC Participants (see “The Trust—Book-Entry-Only System”).

The Trustee may, in its discretion, advance out of its own funds any amounts necessary to permit distributions via the Depository to Beneficial Owners. The Trustee may reimburse itself in the amount of such advance, together with interest thereon at a percentage rate equal to then current overnight federal funds rate, by deducting such amounts from (1) dividend payments or other income of the Trust when such payments or other income is received, (2) the amounts earned or benefits derived by the Trustee on cash held by the Trustee for the benefit of the Trust, and (3) the sale of Securities. Notwithstanding the foregoing, in the event that any advance remains outstanding for more than forty-five (45) Business Days, the Trustee shall sell Securities to reimburse itself for such advance and any accrued interest thereon. Such advances will be secured by a lien on the assets of the Trust in favor of the Trustee.

In addition, as soon as practicable after notice of termination of the Trust, the Trustee will distribute via the Depository and the DTC Participants to each Beneficial Owner redeeming SPDRs in Creation Unit size aggregations prior to the termination date specified in such notice a portion of the Securities and cash as described above (see “Redemption of SPDRs” and “Administration of the Trust—Termination”). Otherwise, the Trustee will distribute to each Beneficial Owner (whether in Creation Unit size aggregations or otherwise), as soon as practical after termination of the Trust, such Beneficial Owner’s pro rata share of the net asset value of the Trust (see “Administration of the Trust—Termination”).

All distributions are made by the Trustee through the Depository and the DTC Participants to Beneficial Owners as recorded on the book entry system of the Depository and the DTC Participants (see “The Trust—Book-Entry-Only System”).

The settlement date for the creation of SPDRs in Creation Unit size aggregations or the purchase of SPDRs in the secondary market must occur on or prior to the Record Date in order for such creator or purchaser to receive a distribution on the next Dividend Payment Date. If the settlement date for such creation or a secondary market purchase occurs after the Record Date, the distribution will be made to the prior securityholder or Beneficial Owner as of such Record Date.

Any Beneficial Owner interested in acquiring additional SPDRs with proceeds received from distributions described above may elect dividend reinvestment through DTC Participants by means of the DTC Dividend Reinvestment Service, described herein (see “Dividend Reinvestment Service”), if such service is available through such Beneficial Owner’s broker.

### **Trust Supervision**

The Trust's Portfolio Securities are not managed and therefore the adverse financial condition of an issuer of securities in the Trust does not, in itself, require the sale of Securities from the Portfolio. The Trustee shall, on a non-discretionary basis, make changes to the Portfolio as described above (see "The Portfolio—Adjustments to the Portfolio").

The Trustee will direct its securities transactions only to brokers or dealers, which may include affiliates of the Trustee, from whom it expects to obtain the most favorable prices or execution of orders.

### **Statements to Beneficial Owners**

With each distribution, the Trustee will furnish for distribution to Beneficial Owners (see "The Trust—Book-Entry-Only System") a statement setting forth the amount being distributed expressed as a dollar amount per SPDR.

Promptly after the end of each fiscal year, the Trustee will furnish to the DTC Participants for distribution to each person who was a Beneficial Owner of SPDRs at the end of such fiscal year, an annual report of the Trust containing financial statements audited by independent accountants of nationally recognized standing and such other information as may be required by applicable laws, rules and regulations.

### **Register of Ownership and Transfer**

The Trustee maintains a record of the creation and redemption of SPDRs in Creation Unit size aggregations as well as creations of SPDRs in connection with the Dividend Reinvestment Service. The Depository maintains a record on its book entry system of the DTC Participant ownership of SPDRs and the number of SPDRs owned (see "The Trust—Book-Entry-Only System"). Certificates are not issued for SPDRs, whether in Creation Unit size denominations or otherwise. Beneficial Owners have the rights accorded to holders of "book-entry" securities under applicable law. Beneficial Owners may transfer SPDRs through the Depository by instructing the DTC Participant holding the SPDRs for such Beneficial Owner in accordance with standard securities industry procedures.

### **Rights of Beneficial Owners**

SPDRs in Creation Unit size aggregations (*i.e.*, 50,000 SPDRs) may be tendered to the Trustee for redemption (see "Redemption of SPDRs"). Beneficial Owners may sell SPDRs in the secondary market, but must accumulate enough SPDRs (*i.e.*, 50,000 SPDRs) to constitute a full Creation Unit in order to redeem through the Trust. The death or incapacity of any Beneficial Owner will not operate to terminate the Trust nor entitle such Beneficial Owner's legal representatives or heirs to claim an

accounting or to take any action or proceeding in any court for a partition or winding up of the Trust.

Beneficial Owners shall not have the right to vote concerning the Trust, except as described below with respect to termination and as otherwise expressly set forth in the Trust Agreement, or in any manner control the operation and management of the Trust, nor shall any Beneficial Owner be liable to any other person by reason of any action taken by the Sponsor or the Trustee.

#### **Amendment**

The Trust Agreement may be amended from time to time by the Trustee and the Sponsor without the consent of any Beneficial Owners (a) to cure any ambiguity or to correct or supplement any provision thereof which may be defective or inconsistent or to make such other provisions in regard to matters or questions arising thereunder as will not adversely affect the interests of Beneficial Owners; (b) to change any provision thereof as may be required by the Commission; (c) to add or change any provision as may be necessary or advisable for the continuing qualification of the Trust as a “regulated investment company” under the Code; (d) to add or change any provision thereof as may be necessary or advisable in the event that NSCC or the Depository is unable or unwilling to continue to perform its functions as set forth therein; and (e) to add or change any provision thereof to conform the adjustments to the Portfolio and the Portfolio Deposit to changes, if any, made by Standard & Poor’s in its method of determining the S&P 500 Index. The Trust Agreement may also be amended from time to time by the Sponsor and the Trustee with the consent of the Beneficial Owners of 51% of the outstanding SPDRs to add provisions to or change or eliminate any of the provisions of the Trust Agreement or to modify the rights of Beneficial Owners; provided, however, that the Trust Agreement may not be amended without the consent of the Beneficial Owners of all outstanding SPDRs if such amendment would (1) permit, except in accordance with the terms and conditions of the Trust Agreement, the acquisition of any securities other than those acquired in accordance with the terms and conditions of the Trust Agreement; (2) reduce the interest of any Beneficial Owner in the Trust; or (3) reduce the percentage of Beneficial Owners required to consent to any such amendment.

Promptly after the execution of any such amendment, the Trustee shall receive from the Depository, pursuant to the terms of the Depository Agreement, a list of all DTC Participants holding SPDRs. The Trustee shall inquire of each such DTC Participant as to the number of Beneficial Owners for whom such DTC Participant holds SPDRs, and provide each such DTC Participant with sufficient copies of a written notice of the substance of such amendment for transmittal by each such DTC Participant to such Beneficial Owners (see “The Trust—Book-Entry-Only System”).



## Termination

The Trust Agreement provides that the Sponsor has the discretionary right to direct the Trustee to terminate the Trust if at any time the net asset value of the Trust is less than \$350,000,000, as such dollar amount shall be adjusted for inflation in accordance with the CPI-U, such adjustment to take effect at the end of the fourth year following the Initial Date of Deposit and at the end of each year thereafter and to be made so as to reflect the percentage increase in consumer prices as set forth in the CPI-U for the twelve month period ending in the last month of the preceding fiscal year.

The Trust will also terminate in the event that SPDRs are delisted from the Exchange. The Exchange will consider the suspension of trading in or the delisting of SPDRs as discussed above (see “Exchange Listing”).

The Trust may also be terminated (a) by the agreement of the Beneficial Owners of 66⅔% of outstanding SPDRs; (b) if the Depository is unable or unwilling to continue to perform its functions as set forth under the Trust Agreement and a comparable replacement is unavailable; (c) if NSCC no longer provides clearance services with respect to SPDRs, or if the Trustee is no longer a participant in NSCC; (d) if Standard & Poor’s ceases publishing the S&P 500 Index; and (e) if the License Agreement is terminated. Currently, the License Agreement is scheduled to expire on January 22, 2018, in accordance with its terms. The parties thereto may extend the term of the License Agreement beyond such date without the consent of any of the Beneficial Owners of SPDRs. The Trust will also terminate by its terms on the Termination Date.

If either the Sponsor or the Trustee shall resign or be removed and a successor is not appointed, the Trust will terminate (see “Resignation, Removal and Liability—The Trustee” and “Resignation, Removal and Liability—The Sponsor”). The dissolution of the Sponsor or its ceasing to exist as a legal entity for any cause whatsoever, however, will not cause the termination of the Trust Agreement or the Trust unless the Trustee deems termination to be in the best interests of Beneficial Owners.

Prior written notice of the termination of the Trust will be given at least twenty (20) days prior to termination of the Trust to all Beneficial Owners in the manner described above (see “The Trust—Book-Entry-Only System”). The notice will set forth the date on which the Trust will be terminated, the period during which the assets of the Trust will be liquidated, the date on which Beneficial Owners of SPDRs (whether in Creation Unit size aggregations or otherwise) will receive in cash the net asset value of the SPDRs held and the date determined by the Trustee upon which the books of the Trust shall be closed. Such notice shall further state that, as of the date thereof and thereafter, neither requests to create additional Creation Units nor

Portfolio Deposits will be accepted, that no additional SPDRs will be created for the purpose of reinvesting dividend distributions, and that, as of the date thereof and thereafter, the portfolio of Securities delivered upon redemption shall be identical in composition and weighting to the Securities held in the Trust as of such date rather than the securities portion of the Portfolio Deposit as in effect on the date request for redemption is deemed received. Beneficial Owners of SPDRs in Creation Unit size aggregations may, in advance of the Termination Date, redeem in kind directly from the Trust (see "Redemption of SPDRs").

Within a reasonable period of time after the Termination Date the Trustee shall, subject to any applicable provisions of law, use its best efforts to sell all of the Securities not already distributed to redeeming Beneficial Owners of Creation Units. The Trustee shall not be liable for or responsible in any way for depreciation or loss incurred by reason of any such sale or sales. The Trustee may suspend such sales upon the occurrence of unusual or unforeseen circumstances, including but not limited to a suspension in trading of a Security, the closing or restriction of trading on a stock exchange, the outbreak of hostilities or the collapse of the economy. Upon receipt of proceeds from the sale of the last Security, the Trustee shall deduct therefrom its fees and all other expenses (see "Expenses of the Trust"). The remaining amount shall be transmitted to the Depository for distribution via the DTC Participants, together with a final statement setting forth the computation of the gross amount distributed. SPDRs not redeemed prior to termination of the Trust will be redeemed in cash at net asset value based on the proceeds of the sale of the Securities. Such redemptions in cash at net asset value shall be available to all Beneficial Owners, with no minimum aggregation of SPDRs required (see "Administration of the Trust—Distributions to SPDR Beneficial Owners").

## **RESIGNATION, REMOVAL AND LIABILITY**

### **The Trustee**

Under the Trust Agreement, the Trustee may resign and be discharged of the Trust created by the Trust Agreement by executing a notice of resignation in writing and filing such notice with the Sponsor and mailing a copy of the notice of resignation to all DTC Participants that are reflected on the records of the Depository as owning SPDRs for distribution to Beneficial Owners as provided above (see "The Trust—Book-Entry-Only System") not less than sixty (60) days before the date such resignation is to take effect. Such resignation will become effective upon the appointment of and the acceptance of the Trust by a successor Trustee or, if no successor is appointed within sixty (60) days after the date such notice of resignation is given, the Trust shall terminate (see "Administration of the Trust—Termination"). The Sponsor, upon receiving notice of such resignation, is obligated to use its best efforts to appoint a successor Trustee promptly.

In case the Trustee becomes incapable of acting as such or is adjudged a bankrupt or is taken over by any public authority, the Sponsor may discharge the Trustee and appoint a successor Trustee as provided in the Trust Agreement. Notice of such discharge and appointment shall be mailed via the DTC Participants to Beneficial Owners by the Sponsor.

Upon a successor Trustee's execution of a written acceptance of an appointment as Trustee for the Trust, such successor Trustee will become vested with all the rights, powers, duties and obligations of the original Trustee.

A successor Trustee is required to be a trust company, corporation or national banking association organized and doing business under the laws of the United States or any state thereof; to be authorized under such laws to exercise corporate trust powers; and to have at all times an aggregate capital, surplus and undivided profit of not less than \$50,000,000.

Beneficial Owners of 51% of the then outstanding SPDRs may at any time remove the Trustee by written instrument(s) delivered to the Trustee and the Sponsor. The Sponsor shall thereupon use its best efforts to appoint a successor Trustee in the manner specified above and in the Trust Agreement.

The Trust Agreement provides that the Trustee is not liable for any action taken in reasonable reliance on properly executed documents or for the disposition of monies or Securities or for the evaluations required to be made thereunder, except by reason of its own gross negligence, bad faith, wilful malfeasance, wilful misconduct, or reckless disregard of its duties and obligations nor is the Trustee liable or responsible in any way for depreciation or loss incurred by reason of the sale by the Trustee of any Securities in the Trust. In the event of the failure of the Sponsor to act, the Trustee may act and is not liable for any such action taken by it in good faith. The Trustee is not personally liable for any taxes or other governmental charges imposed upon or in respect of the Securities or upon the interest thereon or upon it as Trustee or upon or in respect of the Trust which the Trustee may be required to pay under any present or future law of the United States of America or of any other taxing authority having jurisdiction. In addition, the Trust Agreement contains other customary provisions limiting the liability of the Trustee. The Trustee and its directors, subsidiaries, shareholders, officers, employees, and affiliates under common control with the Trustee (each a "Trustee Indemnified Party") will be indemnified from the assets of the Trust and held harmless against any loss, liability or expense incurred without gross negligence, bad faith, wilful misconduct, wilful malfeasance on the part of such Trustee Indemnified Party or reckless disregard of its duties and obligations, arising out of, or in connection with its acceptance or administration of the Trust, including the costs and expenses (including counsel fees) of defending against any claim or liability.

### **The Sponsor**

If at any time the Sponsor shall fail to undertake or perform or become incapable of undertaking or performing any of the duties which by the terms of the Trust Agreement are required of it to be undertaken or performed, or shall resign, or shall become bankrupt or its affairs shall be taken over by public authorities, the Trustee may appoint a successor Sponsor as shall be satisfactory to the Trustee, agree to act as Sponsor itself, or may terminate the Trust Agreement and liquidate the Trust (see "Termination"). Notice of the resignation or removal of the Sponsor and the appointment of a successor shall be mailed by the Trustee to the Depository and the DTC Participants for distribution to Beneficial Owners (see "The Trust—Book-Entry-Only System"). Upon a successor Sponsor's execution of a written acceptance of such appointment as Sponsor of the Trust, such successor Sponsor shall become vested with all of the rights, powers, duties and obligations of the original Sponsor. Any successor Sponsor may be compensated at rates deemed by the Trustee to be reasonable.

The Sponsor may resign by executing and delivering to the Trustee an instrument of resignation. Such resignation shall become effective upon the appointment of a successor Sponsor and the acceptance of such appointment by the successor Sponsor, unless the Trustee either agrees to act as Sponsor or terminates the Trust Agreement and liquidates the Trust, which the Trustee shall do if no successor Sponsor is appointed (see "Termination").

The dissolution of the Sponsor or its ceasing to exist as a legal entity for any cause whatsoever will not cause the termination of the Trust Agreement or the Trust unless the Trustee deems termination to be in the best interests of the Beneficial Owners of SPDRs.

The Trust Agreement provides that the Sponsor is not liable to the Trustee, the Trust or to the Beneficial Owners of SPDRs for taking any action or for refraining from taking any action made in good faith or for errors in judgment, but is liable only for its own gross negligence, bad faith, wilful misconduct or wilful malfeasance in the performance of its duties or its reckless disregard of its obligations and duties under the Trust Agreement. The Sponsor is not liable or responsible in any way for depreciation or loss incurred by the Trust by reason of the sale of any Securities of the Trust. The Trust Agreement further provides that the Sponsor and its directors, subsidiaries, shareholders, officers, employees, and affiliates under common control with the Sponsor (each a "Sponsor Indemnified Party") shall be indemnified from the assets of the Trust and held harmless against any loss, liability or expense incurred without gross negligence, bad faith, wilful misconduct or wilful malfeasance on the part of any Sponsor Indemnified Party in the performance of its duties or reckless disregard of its obligations and duties under the Trust Agreement, including the payment of the costs and expenses of defending against any claim or liability.

## **SPONSOR**

The Sponsor of the Trust is PDR Services LLC, a Delaware limited liability company incorporated on April 6, 1998 with offices c/o the Exchange, 86 Trinity Place, New York, New York 10006. The Sponsor's Internal Revenue Service Employer Identification Number is 52-2127241. The Exchange is the sole member of the Sponsor and the Exchange is a "control person" of the Sponsor as such term is defined in the Securities Act of 1933.

The Sponsor, at its own expense, may from time to time provide additional promotional incentives to brokers who sell SPDRs to the public. In certain instances, these incentives may be provided only to those brokers who meet certain threshold requirements for participation in a given incentive program, such as selling a significant number of SPDRs within a specified time period.

## **TRUSTEE**

The Trustee is State Street Bank and Trust Company, a bank and trust company organized under the laws of the Commonwealth of Massachusetts with its principal place of business at 225 Franklin Street, Boston, Massachusetts 02110. The Trustee's Internal Revenue Service Employer Identification Number is 04-1867445. The Trustee is subject to supervision and examination by the Massachusetts Division of Banks and the Federal Reserve Bank of Boston.

## **DEPOSITORY**

The Depository Trust Company, New York, New York, a limited purpose trust company and member of the Federal Reserve System, acts as Depository for SPDRs. The Depository receives customary fees for its services.

## **LEGAL OPINION**

The legality of the SPDRs offered hereby has been passed upon by Carter, Ledyard & Milburn, New York, New York, as counsel for the Sponsor.

## **INDEPENDENT ACCOUNTANTS**

The financial statements as of September 30, 1998 included in this Prospectus have been so included in reliance upon the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

**INFORMATION AND COMPARISONS RELATING TO TRUST,  
SECONDARY MARKET TRADING, NET ASSET SIZE, PERFORMANCE  
AND TAX TREATMENT**

Information regarding various aspects of the Trust, including the net asset size thereof, as well as the secondary market trading, the performance and the tax treatment of SPDRs, may be included from time to time in advertisements, sales literature and other communications as well as in reports to current or prospective Beneficial Owners.

Information may be provided to prospective investors to help such investors assess their specific investment goals and to aid in their understanding of various financial strategies. Such information may present current economic and political trends and conditions and may describe general principles of investing such as asset allocation, diversification and risk tolerance, as well as specific investment techniques such as indexing and hedging. In addition, information may be presented to prospective or current Beneficial Owners regarding the purchase of SPDRs in the secondary market, such as margin requirements, types of orders that may be entered, and information concerning short sales. Similarly, market data symbols, trading fractions, other trading information and the CUSIP number relating to SPDRs may be included in such information. Comparisons with other investment vehicles, such as mutual funds, may be made with respect to the application of such requirements; costs of fund management and administration; cost and advantages of intraday trading; and rules applicable to short sales.

Information regarding the Trust's net asset size may be stated in communications to prospective or current Beneficial Owners for one or more time periods, including annual, year-to-date or daily periods. Such information may also be expressed in terms of the total number of SPDRs outstanding as of one or more time periods. Factors integral to the size of the Trust's net assets, such as creation volume and activity, may also be discussed, and may be specified from time to time or with respect to various periods of time. Comparisons of such information during various periods may also be made, and may be expressed by means of percentages.

Information may be provided to investors regarding the ability to engage in short sales of SPDRs, including reference to the exemption from the "tick test" provision of the SEC short sale rule (Rule 10a-1 under the Securities Exchange Act of 1934), to permit short sales on "minus" or "zero-minus" ticks. Selling short refers to the sale of securities which the seller does not own, but which the seller arranges to borrow prior to effecting the sale. Institutional investors may be advised that lending their SPDR shares to short sellers may generate stock loan credits which may supplement the return they can earn from an investment in SPDRs. These stock loan credits may provide a useful source of additional income for certain institutional investors who can arrange to lend SPDRs. Potential short sellers may be advised that a short rebate

(functionally equivalent to partial use of proceeds of the short sale) may reduce their cost of selling short.

Information may be provided to investors regarding capital gains distributions by the Trust, including historical information relating to such distributions. Comparisons between the Trust and other investment vehicles such as mutual funds may be made regarding such capital gains distributions, as well as relative tax efficiencies between the Trust and such other investment vehicles (e.g. realization of capital gains or losses to the Trust and to such other investment vehicles in connection with redemption of their respective securities). (See "Tax Status of the Trust" for discussion of tax consequences to Beneficial Owners of SPDRs in connection with the sale or redemption of SPDRs.) Based on projected differences between SPDRs and conventional mutual funds with regard to capital gains distributions, projections may be made regarding comparative capital gains distributions and tax rates for taxable investors holding SPDRs over a long period of time. Comparisons may also be provided regarding the probable tax impact resulting from rebalancing of the Trust portfolio (see "The Portfolio—Adjustments to the Portfolio") and adjustments to the portfolio of an actively managed investment vehicle.

Specifically, information may be provided to prospective or current investors comparing and contrasting the tax efficiencies of conventional mutual funds with SPDRs. Both conventional mutual funds and the SPDR Trust may be required to recognize capital gains incurred as a result of adjustments to the composition of the S&P 500 Index and therefore to their respective portfolios. From a tax perspective, however, a significant difference between a conventional mutual fund and the SPDR Trust is the process by which their shares are redeemed. In cases where a conventional mutual fund experiences redemptions in excess of subscriptions ("net redemptions") and has insufficient cash available to fund such net redemptions, such fund may have to sell stocks held in its portfolio to raise and pay cash to redeeming shareholders. A mutual fund will generally experience a taxable gain or loss when it sells such portfolio stocks in order to pay cash to redeeming fund shareholders. In contrast, the redemption mechanism for SPDRs does not involve selling the portfolio stocks held by the SPDR Trust in the event of a redemption. Instead, the SPDR Trust delivers the actual portfolio of stocks in an "in-kind" exchange to any person redeeming SPDR shares in Creation Unit size aggregations (i.e., 50,000 SPDRs per Creation Unit). While this "in-kind" exchange is a taxable transaction to the redeeming entity (usually a broker/dealer) making the exchange, it generally does not constitute a taxable transaction at the SPDR Trust level and, consequently, there is no realization of taxable gain or loss by the SPDR Trust with respect to such "in-kind" exchanges. In a period of market appreciation of the S&P 500 Index and, consequently, appreciation of SPDR shares, this "in-kind" redemption mechanism has the effect of eliminating the recognition and distribution of those net unrealized gains at the SPDR Trust level. Investors should note that although the same result would obtain for

conventional mutual funds utilizing an "in-kind" redemption mechanism, the opportunities to redeem fund shares by delivering portfolio stocks "in-kind" are limited in most mutual funds.

Investors may be informed that, while no unequivocal statement can be made as to the net tax impact on a conventional mutual fund resulting from the purchases and sales of its portfolio stocks over a period of time, conventional funds that have accumulated substantial unrealized capital gains, if they experience net redemptions and do not have sufficient available cash, may be required to make taxable capital gains distributions that are generated by changes in such fund's portfolio. In contrast, the "in-kind" redemption mechanism of SPDRs may make them more tax efficient investments under most circumstances than comparable conventional mutual fund shares. As discussed above, the "in-kind" redemption feature of the SPDR Trust tends to lower the amount of annual net capital gains distributions to SPDR holders as compared to their conventional mutual fund counterparts. Since shareholders are generally required to pay income tax on capital gains distributions, the smaller the amount of such distributions, the less taxes that are payable currently. To the extent that the SPDR Trust is not required to recognize capital gains, the SPDR holder is able, in effect, to defer tax on such gains until he sells or otherwise disposes of his shares, or the SPDR Trust terminates. If such holder retains his shares until his death, under current law the tax basis of such shares would be adjusted to their then fair market value.

Information regarding the secondary market trading activity of SPDRs also may be presented over one or more stated time periods, such as for daily, monthly, quarterly or annual periods. SPDR secondary market trading volume information may be compared with similar information relating to other issues trading on the Exchange during the same reporting period. Average daily secondary market trading volume of SPDRs may also be reported from time to time. Comparisons of such information during various periods may also be made, and may be expressed by means of percentages.

Information may also be provided in communications to prospective investors or current Beneficial Owners comparing and contrasting the relative advantages of investing in SPDRs as compared to other investment vehicles, such as mutual funds, both on an individual and a group basis (*e.g.*, stock index mutual funds). Such information may include comparisons of costs and expense ratios, expressed either in dollars or basis points, stock lending activities, permitted investments and hedging activities (*e.g.*, engaging in options or futures transactions), and portfolio turnover data and analyses. In addition, such information may quote, reprint or include portions of financial, scholarly or business publications or periodicals, including model allocation schedules or portfolios, as the foregoing relate to the comparison of SPDRs to other investment vehicles, current economic, financial and political conditions, investment philosophy or techniques, or the desirability of owning SPDRs.



In addition, information on the performance of SPDRs on the basis of changes in price per SPDR with or without reinvesting all dividends and/or any distributions of capital in additional SPDRs may be included from time to time in such information. Total return measures the percentage growth in the total dollar value of an investment in SPDRs (reflecting dividends and capital appreciation but without provision for any income taxes payable). Average annualized performance will be stated for various periods. Total return figures may also be stated for a period from the Initial Date of Deposit, a date at least twelve months prior to the end of the reporting period or for annual periods for the life of the Trust. Information on the S&P 500 Index contained in this Prospectus, as updated from time to time, may also be included from time to time in such material. The performance of the Trust, of the S&P 500 Index (provided information is also given reflecting the performance of the Trust in comparison to that S&P 500 Index) or both may also be compared to the performance of money managers as reported in market surveys such as SEI Fund Evaluation Survey (a leading data base of tax-exempt funds) or mutual funds such as those reported by Lipper Analytical Services Inc., Money Magazine Fund Watch, Wiesenberger Investment Companies Service, Morningstar Incorporated and Value Line Investment Survey each of which measures performance following their own specific and well-defined calculation measures, or of the New York Stock Exchange Composite Index, the American Stock Exchange Index (indices of stocks traded on the New York and American Stock Exchanges, respectively), the Dow Jones Industrial Average (an index of 30 widely traded common stocks) or the NASDAQ Composite Index (an unmanaged index of over-the-counter stocks) or similar measurement standards during the same period of time. In addition to all other sources of comparative information, comparative performance figures published by other funds or money managers may be included from time to time. Information may also be included regarding the aggregate amount of assets committed to index investing generally by various types of investors, such as pension funds and other institutional investors, which currently exceeds \$300 billion.

Information on the relative price performance of SPDRs in relation to other securities and/or indices may be represented in the form of "correlation". Correlation is a standard measure of the degree of linear association between two price series, and ranges from minus one hundred percent (-100%) (*i.e.* perfect negative linear association) to positive one hundred percent (100%) (*i.e.*, perfect linear association).

One important difference between SPDRs and conventional mutual fund shares is that the SPDRs are available for purchase or sale on an intraday basis on the American Stock Exchange. An investor who buys shares in a conventional mutual fund will buy or sell shares at a price at or related to the closing net asset value per share, as determined by the fund. In contrast, SPDRs are not offered for purchase or redeemed for cash at a fixed relationship to closing NAV. The tables below illustrate the distribution relationship of SPDRs closing prices to NAV for the period 1/29/93

(the commencement date of the SPDR Trust) through 12/31/98, the distribution relationships of high, low and closing prices over the same period, and distribution of bid/asked spreads for 1998. This table should help investors evaluate some of the advantages and disadvantages of SPDRs relative to funds sold and redeemed at prices related to closing NAV. Specifically, the table illustrates in an approximate way the risks of buying or selling SPDRs at prices less favorable than closing NAV and, correspondingly, the opportunities to buy or sell at prices more favorable than closing NAV.

The investor who purchases or sells SPDRs may wish to evaluate the opportunity to buy or sell on an intraday basis versus the assurance of a transaction at or related to closing NAV. To assist investors in making this comparison, the table illustrates the distribution of percentage ranges between the high and the low price each day and between each extreme daily value and the closing NAV for all trading days from 1/29/93 through 12/31/98. The investor may wish to compare these ranges with the average bid/asked spread on SPDRs and add any commissions charged by a broker. The trading ranges for this period will not necessarily be typical of trading ranges in future years and the bid/asked spread on SPDRs may vary materially over time and may be significantly greater at times in the future. There is some evidence, for example, that the bid/asked spread will widen in more volatile markets and narrow when markets are less volatile. Consequently, the investor should expect wider bid/asked spreads to be associated with wider daily spread ranges.

**Daily Percentage Price Ranges: Average and Frequency Distribution for  
SPDR Trust and S&P 500 Composite Stock Price Index;  
Highs and Lows vs. Close\***

*(From Inception of Trust through 12/31/98 Except as Noted)*

**S&P 500 COMPOSITE STOCK PRICE INDEX**

Range	Daily % Price Range		Intraday High Value Above Closing Value		Intraday Low Value Below Closing Value	
	Frequency	% of Total	Frequency	% of Total	Frequency	% of Total
0— .25%	8	0.53%	704	47.03%	434	28.99%
.25— .5%	232	15.50%	320	21.38%	405	27.05%
.5— 1%	659	44.02%	296	19.77%	397	26.52%
1— 1.5%	339	22.65%	95	6.35%	157	10.49%
1.5— 2%	141	9.42%	45	3.01%	66	4.41%
2— 2.5%	59	3.94%	23	1.54%	20	1.34%
2.5— 3%	29	1.94%	6	0.40%	7	0.47%
3— 3.5%	12	0.80%	4	0.27%	4	0.27%
> 3.5%	18	1.20%	4	0.27%	7	0.47%
Total	1,497	100.00%	1,497	100.00%	1,497	100.00%

Average Daily Range: 1.0499%

**SPDR TRUST**

Range	Daily % Price Range		Intraday High Value Above Closing Value		Intraday Low Value Below Closing Value	
	Frequency	% of Total	Frequency	% of Total	Frequency	% of Total
0— .25%	21	1.40%	613	40.95%	436	29.12%
.25— .5%	243	16.23%	365	24.38%	419	27.99%
.5— 1%	554	37.01%	302	20.17%	383	25.58%
1— 1.5%	372	24.85%	131	8.75%	158	10.55%
1.5— 2%	168	11.22%	33	2.20%	60	4.01%
2— 2.5%	65	4.34%	35	2.34%	20	1.34%
2.5— 3%	41	2.74%	11	0.73%	9	0.60%
3— 3.5%	11	0.73%	3	0.20%	5	0.33%
> 3.5%	22	1.47%	4	0.27%	7	0.47%
Total	1,497	100.00%	1,497	100.00%	1,497	100.00%

Average Daily Range: 1.1045%

\* Source: FactSet Research Systems, Inc.

**Frequency Distribution for SPDR Trust: Highs and Lows vs. Net  
Asset Value; Bid/Asked Spread Distribution\***  
(From Inception of Trust through 12/31/98 Except as Noted)

**SPDR TRUST**

Range	Closing Price on AMEX Above Trust NAV		Closing Price on AMEX Below Trust NAV	
	Frequency	% of Total	Frequency	% of Total
0— .25%	656	90.61%	652	85.34%
.25— .5%	63	8.70%	89	11.65%
.5— 1%	4	0.55%	23	3.01%
1— 1.5%	1	0.14%	0	0.00%
1.5— 2%	0	0.00%	0	0.00%
2— 2.5%	0	0.00%	0	0.00%
2.5— 3%	0	0.00%	0	0.00%
3— 3.5%	0	0.00%	0	0.00%
> 3.5%	0	0.00%	0	0.00%
Total	724	100.00%	764	100.00%

Note: The closing price on the AMEX equaled the NAV on nine days.

Close was within 0.25% of NAV better than 88% of the time.

**SPDR BID/ASKED SPREAD DISTRIBUTION (1998 Only)**

Range	% of Total
$\frac{1}{64}$ — $\frac{1}{16}$	3.47%
$\frac{5}{64}$ — $\frac{1}{8}$	41.46%
$\frac{9}{64}$ — $\frac{3}{16}$	37.93%
$\frac{13}{64}$ — $\frac{1}{4}$	15.55%
$\frac{17}{64}$ — $\frac{5}{16}$	1.17%
$\frac{21}{64}$ — $\frac{3}{8}$	0.32%
> $\frac{25}{64}$	0.10%
Total	100.00%

The price range of shares for 1998 was from  $90\frac{29}{32}$  to  $124\frac{3}{4}$ ; consequently,  $\frac{1}{8}$  was from 0.14% to 0.10% of the share price.

\* Source: American Stock Exchange LLC

Information relating to the relative price performance of SPDRs may be compared against a wide variety of investment categories and asset classes, including common stocks, small capitalization stocks, long and intermediate term corporate and government bonds, Treasury bills, the rate of inflation in the United States (based on the Consumer Price Index ("CPI")) and combinations of various capital markets. Historical returns of these and other capital markets in the United States may be provided by independent statistical studies and sources, such as those provided by Ibbotson Associates of Chicago, Illinois. The performance of these capital markets is based on the returns of different indices. Information may be presented using the performance of these and other capital markets to demonstrate general investment strategies. So, for example, performance of SPDRs may be compared to the performance of selected asset classes such as short-term U.S. Treasury bills, long-term U.S. Treasury bonds, long-term corporate bonds, mid-capitalization stocks, foreign stocks and small capitalization stocks and may also be measured against the rate of inflation as set forth in well-known indices (such as the CPI). Performance comparisons may also include the value of a hypothetical investment in any of these capital markets. Performance of SPDRs may also be compared to that of other indices or compilations that may be developed and made available to the investing public in the future. Of course, such comparisons will only reflect past performance of SPDRs and the investment categories, indices or compilations chosen and no guarantees can be made of future results regarding the performance of either SPDRs or the asset classes chosen for such comparisons.

#### **DIVIDEND REINVESTMENT SERVICE**

The Trust has made the DTC book-entry Dividend Reinvestment Service (the "Service") available for use by Beneficial Owners through DTC Participants for reinvestment of their cash proceeds. Note that some DTC Participants may not elect to utilize the Service; therefore, after the Service is made available for SPDRs, an interested SPDR investor may wish to contact such investor's broker to ascertain the availability of the Service through such broker. Interested Beneficial Owners should also note that each broker may require investors to adhere to specific procedures and timetables in order to participate in the Service and such investors should ascertain from their broker such necessary details. SPDRs acquired pursuant to the Service will be held by the Beneficial Owners in the same manner, and subject to the same terms and conditions, as for original ownership of SPDRs.

Distributions reinvested in additional SPDRs through the Service will nevertheless be taxable dividends to Beneficial Owners to the same extent as if received in cash.

The Trustee will utilize the cash proceeds of dividends received from all Beneficial Owners participating in reinvestment through the Service to obtain Index

Securities necessary to create the requisite number of SPDRs at the close of business on each SPDR distribution date. Any cash balance remaining after the requisite number of SPDRs has been created will be distributed, on a pro rata basis, to all Beneficial Owners who participated in the Service. Note that brokerage commissions, if any, incurred in obtaining the Index Securities necessary to create additional SPDRs with the cash from the distributions will be an expense of the Trust.\*

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- \* It is difficult to estimate the annual dollar amount of brokerage commissions that might be incurred in connection with the Dividend Reinvestment Service during any fiscal year. The Trustee estimates that during fiscal year 1998, the approximate amount of annual brokerage commissions incurred in implementing the Service was less than \$0.001 per SPDR. There can be no guarantee that either the size of the Trust or the number of outstanding SPDRs will remain constant, or that dividend payments, the cost of brokerage commissions incurred to purchase Index Securities or Beneficial Owner participation will remain the same as it was during fiscal year 1998.

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**STANDARD & POOR'S DEPOSITARY  
RECEIPTS (SPDRs)  
SPDR TRUST, SERIES 1**

**SPONSOR:  
PDR SERVICES LLC**

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This Prospectus does not include all of the information with respect to the SPDR Trust set forth in its Registration Statement filed with the Securities and Exchange Commission (the "Commission") in Washington, D.C. under the:

- Securities Act of 1933 (File No. 33-46080) and
- Investment Company Act of 1940 (File No. 811-7330).

**To obtain copies from the Commission at prescribed rates—**

**Write:** Public Reference Section of the Commission  
450 Fifth Street, N.W., Washington, D.C. 20549

**Call:** 1-800-SEC-0330

**Visit:** <http://www.sec.gov>

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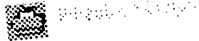
No person is authorized to give any information or make any representation about the SPDR Trust not contained in this Prospectus, and you should not rely on any other information. Read and keep both parts of this Prospectus for future reference.

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**Prospectus dated January 25, 1999**

**T-Bills, Notes  
& Bonds** online

Bureau of the  
**Public Debt**  
online



## Treasury STRIPS

The Treasury STRIPS program was introduced in February 1985. STRIPS is the acronym for Separate Trading of Registered Interest and Principal of Securities. The STRIPS program lets investors hold and trade the individual interest and principal components of eligible Treasury notes and bonds as separate securities.

### What is a stripped security?

When a Treasury fixed-principal or inflation-indexed note or bond is stripped, each interest payment and the principal payment becomes a separate zero-coupon security. Each component has its own identifying number and can be held or traded separately. For example, a Treasury note with 10 years remaining to maturity consists of a single principal payment at maturity and 20 interest payments, one every six months for 10 years. When this note is converted to STRIPS form, each of the 20 interest payments and the principal payment becomes a separate security. STRIPS are also called zero-coupon securities because the only time an investor receives a payment during the life of a STRIP is when it matures.

### How do I buy STRIPS?

The Treasury does not issue or sell STRIPS directly to investors. STRIPS can be purchased and held only through financial institutions and government securities brokers and dealers.

### Why do investors hold STRIPS?

STRIPS are popular with investors who want to receive a known payment at a specific future date. For example, some State lotteries invest the present value of large lottery prizes in STRIPS to be sure that funds are available when needed to meet annual payment obligations that result from the prizes. Pension funds invest in STRIPS to match the payment flows of their assets with those of their liabilities to make benefit payments. STRIPS are also popular investments for individual retirement accounts, 401(k)-type savings plans, and other income tax-advantaged accounts that permit earnings to accumulate without incurring immediate income tax consequences. See the Federal income tax treatment of STRIPS section of this document.

The Department of the Treasury does not provide investment advice. Your investment advisor, financial institution, government securities broker or dealer, accountant, and/or tax advisor can discuss STRIPS in the context of your investment needs.

### What Treasury securities are eligible to be stripped?

The offering announcement for each Treasury note or bond states whether the security is eligible to be stripped. In practice, all fixed-principal 10-year notes and 30-year bonds issued on or after February 15, 1985 can be stripped. All fixed-principal Treasury notes of less than 10 years to maturity issued on or after

fixed-principal Treasury notes of less than 10 years to maturity issued on or after September 30, 1997 can be stripped. Moreover, all Treasury inflation-indexed notes and bonds, first issued in January 1997, can be stripped.

### **How is a Treasury security stripped?**

[Click for text links](#)

A financial institution, government securities broker, or government securities dealer can convert an eligible Treasury security into interest and principal components through the commercial book-entry system. Generally, an eligible security can be stripped at any time from its issue date until its call or maturity date.

Securities are assigned a standard identification code known as a CUSIP number. CUSIP is the acronym for Committee on Uniform Security Identification Procedures. Just as a fully constituted security has a unique CUSIP number, each STRIPS component has a unique CUSIP number. All interest STRIPS that are payable on the same day, even when stripped from different securities, have the same generic CUSIP number. However, the principal STRIPS from each note or bond have a unique CUSIP number.

For example, if several fixed-principal notes and bonds that pay interest on May 15 and November 15 are stripped, the interest STRIPS that are payable on the same day (for example, May 15, 2005) have the same CUSIP number. However, the principal STRIPS of each fixed-principal note and bond have a unique CUSIP number, and principal STRIPS with different CUSIP numbers that pay on the same day are not interchangeable (or "fungible").

In the case of inflation-indexed notes and bonds, the semiannual interest STRIPS that are payable on the same day (for example April 15, 2005) have the same CUSIP number. The principal STRIPS also have a unique CUSIP number. The CUSIP numbers for STRIPS from inflation-indexed securities are different from those for STRIPS from fixed-principal securities.

See the Federal rules pertaining to STRIPS on this website (31 C.F.R. 356.31) for more information on stripping. Also, see Appendix B to 31 C.F.R., Part 356, for an example of the adjustment that must be made to the value of a stripped interest component of an inflation-indexed security to make it interchangeable with the interest components of other inflation-indexed securities with the same payment date.

### **What are minimum par amounts for stripping?**

Fixed-principal securities: The minimum face amount needed to strip a fixed-principal note or bond is an amount that is a multiple of \$1,000 and produces interest payments that are multiples of \$1,000. The table in Exhibit C to 31 C.F.R., Part 356 displays the minimum face amounts required to strip.

Inflation-indexed securities: The minimum face amount needed to strip an inflation-indexed note or bond is \$1,000 and any par amount to be stripped above \$1,000 must be in a multiple of \$1,000.

### **Are STRIPS safe investments?**

STRIPS are obligations of the Treasury and are backed by the full faith and credit of the United States.

Market prices of STRIPS fluctuate more than the prices of fully constituted securities of the same maturity. The market price of a STRIP reflects the fact that there is only one payment on a specific date in the future. The market price of a fully constituted Treasury note or bond reflects the fact that there is a series of semiannual interest payments and a final payment at maturity. The longer the maturity of STRIPS, the greater is the potential market price fluctuation.

STRIPS sell at a discount because there are no periodic interest payments. An investor's income on a STRIP that is held to maturity is the difference between the purchase price and the amount received at maturity. Long-term STRIPS have lower market prices than short-term STRIPS, because long-term STRIPS accrue interest over a longer period of time. For example, assume that three STRIPS are quoted in the market at a yield of 6.50 percent. The price for STRIPS with 25 years remaining to maturity would be \$202.07 per \$1,000 face amount; that for STRIPS with 10 years remaining to maturity would be \$527.47 per \$1,000 face amount, while that for 2-year STRIPS would be \$879.91 per \$1,000 face amount.

The total income from a STRIPS security is fixed at the time of purchase when the security is held to maturity. When STRIPS are sold before maturity, however, the investor could realize a gain or loss because the market price could be more or less than the purchase price plus the amount of interest (and the inflation adjustment to principal in the case of inflation-indexed notes and bonds) that has accrued between the time the security was purchased and the sale date.

### **Are STRIPS readily available?**

There is a large and active market for STRIPS components of fixed-principal securities. Many brokers and dealers make markets in these securities and other market participants include pension funds, financial institutions, investment funds, and individuals. While the liquidity of particular issues may vary from time to time, in general a busy market exists for STRIPS with maturities from a few months to 30 years. A market has not yet developed for stripped components of inflation-indexed securities.

### **What is the Federal income tax treatment of STRIPS?**

Generally, an investor must report as income, for Federal income tax purposes, the interest earned on STRIPS in the year in which it is earned. Inflation adjustments to principal on inflation-indexed securities must also be reported in the year earned. Income must be reported even though it is not received until maturity or the STRIPS are sold. Every investor in STRIPS receives a report each year displaying the amount of STRIPS interest income from the financial institution, government securities broker, or government securities dealer that

maintains the account in which the STRIPS are held. This statement is known as IRS Form 1099 - OID, the acronym for original issue discount. The income-reporting requirement has meant that STRIPS are attractive investments for tax-deferred accounts, such as individual retirement accounts and 401(k) plans, and for non-taxable accounts, which include pension funds.

The income tax treatment of STRIPS also takes into account market discount and capital gains or losses, if any. Therefore, an investor would be well advised to review possible income tax implications before investing in STRIPS. For further information on the tax treatment of STRIPS and other zero-coupon securities, see Internal Revenue Service Publication 550, "Investment Income and Expenses" on the Internal Revenue Service website at:

[http://www.irs.gov/forms\\_pubs/findfiles.html](http://www.irs.gov/forms_pubs/findfiles.html)

### **Can the STRIPS components be reassembled into a whole security?**

STRIPS components can be reassembled or "reconstituted" into a fully constituted security in the commercial book-entry system. To reconstitute a security, a financial institution or government securities broker or dealer must obtain the appropriate principal component and all unmatured interest components for the security being reconstituted. The principal and interest components must be in the appropriate minimum or multiple amounts for a security to be reconstituted.

The flexibility to strip and reconstitute securities allows investors to take advantage of various holding and trading strategies under changing financial market conditions that may tend to favor trading and holding STRIPS or fully constituted Treasury securities.

### **Further questions?**

If you have questions about buying or selling STRIPS, contact your financial institution, broker, dealer, or investment advisor. See also 31 CFR 356.31 for rules relating to stripping and reconstituting Treasury securities. If you have specific questions on the process for stripping or reconstituting Treasury securities, call the Bureau of the Public Debt at (202) 691-3550.

*Updated October 5, 1999*